INTERNATIONAL MARKETING

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Chapter 1

Stages of International Marketing

Learning objectives:

- **Explain the expanding scope of the marketing function as companies become global**

- **Compare and contrast the stages of international marketing involvement**

- **Analyze any given article in terms of the stages of international marketing involvement**

Reasons for entering international markets

Many marketers have found the international marketplace to be extremely hostile. A study by Baker and Kynak, for example, found that less than 20 percent of firms in Texas with export potential actually carried out business in international markets. But although many firms view in markets with trepidation, others still make the decision to go international. Why?

In one study, the following motivating factors were given for initiating overseas marketing involvement (in order of importance):

- large market size
- stability through diversification
- profit potential
- unsolicited orders
- proximity of market
- excess capacity
- offer by foreign distributor
- increasing growth rate
- smoothing out business cycles

Other empirical studies over a number of years have pointed to a wide variety of reasons why companies initiate international involvement. These include the saturation of the domestic market, which leads firms either to seek other less competitive markets or to take on the competitor in its home markets; the emergence of new markets, particularly in the developing world; government incentives to export; tax incentives offered by foreign governments to establish manufacturing plants in their countries in order to create jobs; the availability of cheaper or more skilled labor; and an attempt to minimize the risks of a recession in the home country and spread risk.

Reasons to avoid international markets

Despite attractive opportunities, most businesses do not enter foreign markets. The reasons given for not going international are numerous. The biggest barrier to entering foreign markets is seen to be a fear by these companies that their products are not marketable overseas, and a consequent preoccupation with the domestic market. The following points were highlighted by the findings in the previously mentioned study by Barker and Kaynak, who listed the most important barriers:

too much red tape

trade barriers

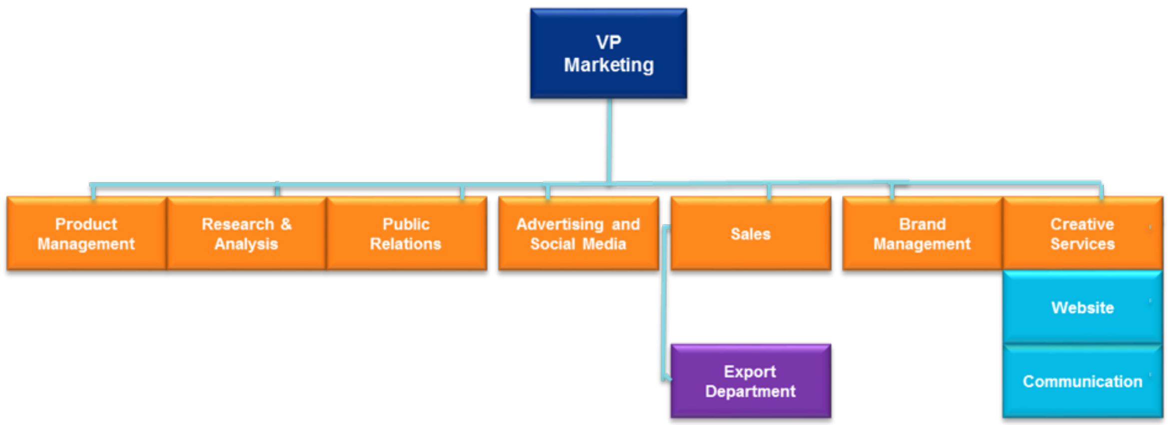
transportation difficulties

lack of trained personnel

lack of incentives

lack of coordinated assistance

unfavorable conditions overseas



slow payments by buyers

lack of competitive products

payment defaults

language barriers

It is the combination of these factors that determines not only whether companies become involved in international markets, but also the degree of any involvement.

The previous section is taken from *Core Principles of International Marketing* from the Washington State. University's open texts, PB PRESSBOOKS.

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Chapter 2

Culture & International Marketing

Learning objectives:

• Formulate a definition of culture and its impact on international marketing

• Give own examples of material and non-material cultural elements based on your own national culture

• Discuss how your own cultural glasses color your views on self-reference criterion and ethnocentrism

Introduction

Humans are social creatures. Since the dawn of Homo sapiens, nearly 250,000 years ago, people have grouped together into communities in order to survive. Living together, people form common habits and behaviors – from specific methods of childrearing to preferred techniques for obtaining food. In modern-day Paris, many people shop daily at outdoor markets to pick up what they need for their evening meal, buying cheese, meat, and vegetables from different specialty stalls. In the United States, the majority of people shop once a week at supermarkets, filling large carts to the brim. How would a Parisian perceive U.S. shopping behaviors that Americans take for granted?

Almost every human behavior, from shopping to marriage to expressions of feelings, is learned. In the United States, people tend to view marriage as a choice between two people, based on mutual feelings of love. In other nations and in other times, marriages have been arranged through an intricate process of interviews and negotiations between entire families, or in other cases, through a direct system such as a "mail order bride." To someone raised in New York City, the marriage customs of a family from Nigeria may seem strange, or even wrong. Conversely, someone from a traditional Kolkata family might be perplexed with the idea of romantic love as the foundation for marriage lifelong commitment. In other words, the way in which people view marriage depends largely on what they have been taught.

Behavior based on learned customs is not a bad thing. Being familiar with unwritten rules helps people feel secure and "normal." Most people want to live their daily lives confident that their behaviors will not be challenged or disrupted. But even an action as seemingly simple as commuting to work evidences a great deal of cultural propriety.

How would a visitor from suburban America act and feel on this crowded Tokyo train?

Take the case of going to work on public transportation. Whether commuting in Dublin, Cairo, Mumbai, or San Francisco, many behaviors will be the same in all locations, but significant differences also arise between cultures. Typically, a passenger would find a marked bus stop or station, wait for his bus or train, pay an agent before or after boarding, and quietly take a seat if one is available. But when boarding a bus in Cairo, passengers might have to run, because buses there often do not come to a full stop to take on patrons. Dublin bus riders would be expected to extend an arm to indicate that they want the bus to stop for them. And when boarding a commuter train in Mumbai, passengers must squeeze into overstuffed cars amid a lot of pushing and shoving on the crowded platforms. That kind of behavior would be considered the height of rudeness in United States, but in Mumbai it reflects the daily challenges of getting around on a train system that is taxed to capacity.

In this example of commuting, culture consists of thoughts (expectations about personal space, for example) and tangible things (bus stops, trains, and seating capacity). Material culture refers to the objects or belongings of a group of people. Metro passes and bus tokens are part of material culture, as are automobiles, stores, and the physical structures where people worship.

Nonmaterial culture, in contrast, consists of the ideas, attitudes, and beliefs of a society. Material and nonmaterial aspects of culture are linked, and physical objects often symbolize cultural ideas. A metro pass is a material object, but it represents a form of nonmaterial culture, namely,

capitalism, and the acceptance of paying for transportation. Clothing, hairstyles, and jewelry are part of material culture, but the appropriateness of wearing certain clothing for specific events reflects nonmaterial culture. A school building belongs to material culture, but the teaching methods and educational standards are part of education's nonmaterial culture. These material and nonmaterial aspects of culture can vary subtly from region to region. As people travel farther afield, moving from different regions to entirely different parts of the world, certain material and nonmaterial aspects of culture become dramatically unfamiliar.

What happens when we encounter different cultures? As we interact with cultures other than our own, we become more aware of the differences and commonalities between others' worlds and our own.

Ethnocentrism & cultural relativism

Despite how much humans have in common, cultural differences are far more prevalent than cultural universals. For example, while all cultures have language, analysis of particular language structures and conversational etiquette reveal tremendous differences. In some Middle Eastern cultures, it is common to stand close to others in conversation. North Americans keep more distance, maintaining a large "personal space." Even something as simple as eating and drinking varies greatly from culture to culture. If your professor comes into an early morning class holding a mug of liquid, what do you assume she is drinking? In the United States, it's most likely filled with coffee, not Earl Grey tea, a favorite in England, or Yak Butter tea, a staple in Tibet.

The way cuisines vary across cultures fascinates many people. Some travelers pride themselves on their willingness to try unfamiliar foods, like celebrated food writer Anthony Bourdain, while others return home expressing gratitude for their native culture's fare. Often, Americans express disgust at other cultures' cuisine, thinking it's gross to eat meat from a dog or guinea pig, for example, while they don't question their own habit of eating cows or pigs. Such attitudes are an example of ethnocentrism, or evaluating and judging another culture based on how it compares to one's own cultural norms. Ethnocentrism, as sociologist William Graham Sumner (1906) described the term, involves a belief or attitude that one's own culture is better than all others. Almost everyone is a little bit ethnocentric. For example, Americans tend to say that people from England drive on the "wrong" side of the road, rather than the "other" side. Someone from a country where dog meat is standard fare might find it off-putting to see a dog in a French restaurant – not on the menu, but as a pet and patron's companion.

A high level of appreciation for one's own culture can be healthy; a shared sense of community pride, for example, connects people in a society. But ethnocentrism can lead to disdain or dislike for other cultures, causing misunderstanding and conflict. People with the best intentions sometimes travel to a society to "help" its people, seeing them as uneducated or backward; essentially inferior. In reality, these travelers are guilty of cultural imperialism, the deliberate imposition of one's own cultural values on another culture. Europe's colonial expansion, begun in the 16th century, was often accompanied by a severe cultural imperialism. European colonizers often viewed the people in the lands they colonized as uncultured savages who were in need of European governance, dress, religion, and other cultural practices. A more modern example of cultural imperialism may include the work of international aid agencies who introduce agricultural methods and plant species from developed countries while overlooking indigenous varieties and agricultural approaches that are better suited to the particular region.

Ethnocentrism can be so strong that when confronted with all the differences of a new culture, one may experience disorientation and frustration. In sociology, we call this culture shock. A traveler from Chicago might find the nightly silence of rural Montana unsettling, not peaceful. An exchange student from China might be annoyed by the constant interruptions in class as other students ask questions – a practice that is considered rude in China. Perhaps the Chicago traveler was initially captivated with Montana's quiet beauty and the Chinese student was originally excited to see an American-style classroom firsthand. But as they experience unanticipated differences from their own culture, their excitement gives way to discomfort and doubts about how to behave appropriately in the new situation. Eventually, as people learn more about a culture, they recover from culture shock.

Some scholars think cultural relativism is an absolute, that we should never judge another culture's beliefs and practices as inferior to our own. Other scholars think cultural relativism makes sense up to a point, but that there are some practices that should be condemned, even if they are an important part of another culture, because they violate the most basic standards of humanity. For example, a common practice in areas of India and Pakistan is dowry deaths, where a husband and his relatives murder the husband's wife because her family has not provided the dowry they promised when the couple got married Often they burn the wife in her kitchen with cooking oil or gasoline and make it look like an accident. The number of such dowry deaths is estimated to be at least several hundred every year and perhaps as many as several thousand. Should we practice cultural relativism and not disapprove of dowry deaths? Or is it fair to condemn this practice, even if it is one that many people in those nations accept?

Because dowry death is so horrible, you might be sure we should not practice cultural relativism for this example. However, other cultural practices such as cow worship might sound odd to you but are not harmful, and you would probably agree we should accept these practices on their own terms. Other practices lie between these two extremes. Consider the eating of dog meat, In China, South Korea, and other parts of Asia, dog meat is considered a delicacy, and people sometimes kill dogs to eat them. For a Westerner, eating it can feel a little strange, but is it morally different from eating, say, pork? The dogs brought to table in China are not people's pets, but are raised as food, like pigs. Is it any worse than eating pork or slaughtering cattle in order to eat beef? Cultural relativism and ethnocentrism certainly raise difficult issues in today's increasingly globalized world.

Perhaps the greatest challenge for sociologists studying different cultures is the matter of keeping a perspective. It is impossible for anyone to keep all cultural biases at bay; the best we can do is strive to be aware of them. Pride in one's own culture doesn't have to lead to imposing its values on others. And an appreciation for another culture shouldn't preclude individuals from studying it with a critical eye.

The previous section is taken from Saylor.org's *Introduction to Sociology*, Chapter 3: Culture.

The self-reference criterion & ethnocentrism

The importance of the self-reference criterion (SRC) in international marketing to successful international marketing is adaptation to environmental differences from one market to another. Adaptation is a conscious effort on the part of the international marketer to anticipate the influences of both the foreign and domestic uncontrollable factors on a marketing mix and then to adjust the marketing mix to minimize the effects. The primary obstacles to success in international marketing are a person's self-reference criterion (SRC) and an associated ethnocentrism. The SRC is an unconscious reference to one's own cultural values, experiences, and knowledge as a basis for decisions, and is closely connected is ethnocentrism. Ethnocentrism was particularly a problem for American managers at the beginning of the 21st century because of America's dominance in the world economy during the late 1990s. Ethnocentrism is generally a problem when managers from affluent countries work with managers and markets in less affluent countries. Both the SRC and ethnocentrism impede the ability to assess a foreign market in its true light. When confronted with a set of facts, we react spontaneously on the basis of knowledge assimilated over a lifetime—knowledge that is a product of the history of our culture. We seldom stop to think about a reaction; we simply react. Thus, when faced with a problem in another culture, our tendency is to react instinctively and refer to our SRC for a solution. Our reaction, however, is based on meanings, values, symbols, and behavior relevant to our own culture and usually different from those of the foreign culture. Such decisions are often not good ones. To illustrate the impact of the SRC, consider misunderstandings that can occur about personal space between people of different cultures. In the United States, unrelated individuals keep a certain physical distance between themselves and others when talking or in groups. We do not consciously think about that distance; we just know what feels right without thinking. When someone is too close or too far away, we feel uncomfortable and either move farther away or get closer to correct the distance. In doing so, we are relying on our SRC

In some cultures, the acceptable distance between individuals is substantially less than that which is comfortable for Americans. When someone from another culture approaches an American too closely, the American, unaware of that culture's acceptable distance, unconsciously reacts by backing away to restore the proper distance (i.e., proper by American standards), and confusion results for both parties. Americans assume foreigners are pushy, while foreigners assume Americans are unfriendly and literally "standoffish." Both react according to the values of their own SRCs, making both victims of a cultural misunderstanding. Your self-reference criterion can prevent you from being aware of cultural differences or from recognizing the importance of those differences. Thus, you might fail to recognize the need to take action, you might discount the cultural differences that exist among countries, or you might react to a situation in a way offensive to your hosts.

A common mistake made by Americans is to refuse food or drink when offered. In the United States, a polite refusal is certainly acceptable, but in Asia or the Middle East, a host is offended if you refuse hospitality. Although you do not have to eat or drink much, you do have to accept the offering of hospitality.

Understanding and dealing with the SRC are two of the more important facets of international marketing. Ethnocentrism and the SRC can influence an evaluation of the appropriateness of a domestically designed marketing mix for a foreign market. If U.S. marketers are not aware, they might evaluate a marketing mix based on U.S. experiences (i.e., their SRC) without fully appreciating the cultural differences that require adaptation. Certainly, having a great cup of coffee handy at a major tourist attraction seems like a great idea. So Starbucks opened a store in the Forbidden City in Beijing. While American tourists were happy to buy, Chinese took great umbrage with the tactic. It took Starbucks six years to correct the error. Women's clothing maker Zara headquartered in Spain fixed things much faster. They had offered online a striped blouse with a yellow six-pointed star emblazoned across the heart. For Jews, it was reminiscent of World War II concentration camp uniforms. Consumers complained, and Zara took the product off the market immediately. Damage was still done. Both of these examples were real mistakes made by major companies stemming from their reliance on their SRC in making a decision. When marketers take the time to look beyond their own self-reference criteria, the results are more positive. A British manufacturer of chocolate biscuits (cookies, in American English), ignoring its SRC, knew that it must package its biscuits differently to accommodate the Japanese market. Thus, in Japan, McVitie's chocolate biscuits are wrapped individually, packed in presentation cardboard boxes, and priced about three times higher than in the United Kingdom—the cookies are used as gifts in Japan and thus must look and be perceived as special. Unilever, appreciating the uniqueness of its markets, repackaged and reformulated its detergent for Brazil. One reason was that the lack of washing machines among poorer Brazilians made a simpler soap formula necessary. In addition, because many people wash their clothes in rivers, the powder was packaged in plastic rather than paper so it would not get soggy. Finally, because the Brazilian poor are price conscious and buy in small quantities, the soap was packaged in small, low-priced packages. Even McDonald's modifies its traditional Big Mac in India, where it is known as the Maharaja Mac. This burger features two mutton patties, because most Indians consider cows sacred and do not eat beef. In each of these examples, had the marketers' own self-reference criteria been the basis for decisions, none of the necessary changes would have been readily apparent based on their home-market experience.

The most effective way to control the influence of ethnocentrism and the SRC is to recognize their effects on our behavior. Although learning every culture in depth and being aware of every important difference is obviously humanly impossible, an awareness of the need to be sensitive to differences and to ask questions when doing business in another culture can help you avoid many of the mistakes possible in international marketing. Asking the appropriate question helped the Vicks Company avoid making a mistake in Germany. It discovered that in German, "Vicks" sounds like the crudest slang equivalent of "intercourse," so it changed the name to "Wicks" before introducing the product. Be aware, also, that not every activity within a marketing program is different from one country to another; indeed, there probably are more similarities than differences. For example, the McVitie's chocolate biscuits mentioned earlier are sold in the United States in the same package as in the United Kingdom. Such similarities, however, may lull the marketer into a false sense of apparent sameness. This apparent sameness, coupled with the self-reference criterion, is often the cause of international marketing problems. Undetected similarities do not cause problems; however, the one difference that goes undetected can create a marketing failure. To avoid errors in business decisions, the knowledgeable marketer will conduct a cross- cultural analysis that isolates the SRC influences and maintain vigilance regarding ethnocentrism. The following steps are suggested as a framework for such an analysis:

1. Define the business problem or goal in home-country cultural traits, habits, or norms.

2. Define the business problem or goal in foreign-country cultural traits, habits, or norms through consultations with natives of the target country. Make no value judgments.

3. Isolate the SRC influence in the problem and examine it carefully to see how it complicates the problem.

4. Redefine the problem without the SRC influence and solve for the optimum business goal situation.

An American sales manager newly posted to Japan decided that his Japanese sales representatives did not need to come into the office every day for an early morning meeting before beginning calls to clients in Tokyo. After all, that was how things were done in the United States. However, the new policy, based on both the American's SRC and a modicum of ethnocentrism, produced a precipitous decline in sales performance. In his subsequent discussions with his Japanese staff, he determined that Japanese sales representatives are motivated mostly by peer pressure. Fortunately, he was able to recognize that his SRC and his American "business acumen" did not apply in this case in Tokyo. A return to the proven system of daily meetings brought sales performance back to previous levels. The cross-cultural analysis approach requires an understanding of the culture of the foreign market as well as one's own culture. Surprisingly, understanding one's own culture may require additional study, because much of the cultural influence on market behavior remains at a subconscious level and is not clearly defined.

Developing Global Awareness Opportunities in global business abound for those who are prepared to confront myriad obstacles with optimism and a willingness to continue learning new ways. The successful businessperson in the 21st century will have global awareness and a frame of reference that goes beyond a region or even a country and encompasses the world. To be globally aware is to have (1) tolerance of and a willingness to learn about cultural differences and (2) knowledge of cultures, history, world market potential, and global economic, social, and political trends. Close akin to global awareness is what others have called "cultural intelligence" or CQ. Aspects of the latter have been shown to enhance international marketing efforts. Tolerance for cultural differences is crucial in international marketing.

Tolerance is understanding cultural differences and accepting and working with others whose behaviors may be different from yours. You do not have to accept as your own the cultural ways of another, but you must allow others to be different and equal. For example, the fact that punctuality is less important in some cultures does not make them less productive, only different. The tolerant person understands the differences that may exist between cultures and uses that knowledge to relate effectively. A globally aware person is knowledgeable about cultures and history. Knowledge of cultures is important in understanding behavior in the marketplace or in the boardroom. Knowledge of history is important because the way people think and act is influenced by their history. Some Latin Americans' reluctance toward foreign investment or Chinese reluctance to open completely to outsiders can be understood better if you have a historical perspective.

Global awareness also involves knowledge of world market potentials and global economic, social, and political trends. Over the next few decades, enormous changes will take place in the market potentials in almost every region of the world, all of which a globally aware person must continuously monitor. Finally, a globally aware person will keep abreast of global economic, social, and political trends, because a country's prospects can change as these trends shift direction or accelerate. The former republics of the Soviet Union, along with Russia, eastern Europe, China, India, Africa, and Latin America, are undergoing economic, social, and political changes that have already altered the course of trade and defined new economic powers. The knowledgeable marketer will identify opportunities long before they become evident to others. It is the authors' goal in this text to guide the reader toward acquiring global awareness.

Global awareness can and should be built into organizations using several approaches. The obvious strategy is to select individual managers specifically for their demonstrated global awareness. Global awareness can also be obtained through personal relationships in other countries. Indeed, market entry is very often facilitated through previously established social ties. Certainly, successful long-term business relationships with foreign customers often result in an organizational global awareness based on the series of interactions required by commerce. Foreign agents and partners can help directly in this regard. But perhaps the most effective approach is to have a culturally diverse senior executive staff or board of directors. Unfortunately, American managers seem to see relatively less value in this last approach than managers in most other countries.

The previous section is taken from *International Marketing* by Philip Cateora, Mary Gilly, John Graham, and Bruce Money.

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Chapter 3

Fundamentals of Global Marketing

Learning objectives:

- **Analyze the opening case in terms of the four components of marketing: product, pricing, place, and promotion**

- **Differentiate between target segmentation and marketing in the international arena**

- **Discuss current examples of issues related to growing middle class, gray markets, and counterfeit markets in the international arena**

Case studies

Colonel Sanders is no chicken!

KFC Japan

Kentucky Fried Chicken (KFC) was the first American fast-food restaurant to enter China, opening its first outline there in 1987 in Beijing. McDonald's, didn't open a restaurant in China until 1990. Today, KFC has 2,872 restaurants in China, which generate over $2 billion in sales for its parent company, Yum! Brands. The main factor contributing to KFC's success in China is its localization strategy. Let us see how KFC did it.

When KFC first entered the Chinese market, Chinese law stipulated that foreign companies could only operate in China if they had a local partner. KFC selected partners who had connections to government, so that it could benefit from their resources and contacts. KFC learned a lot from its local partners, and once joint ventures were no longer required, KFC chose a leadership team that knew Chinese culture intimately. Rather than sending expatriates to China to lead the expansion, for example, KFC selected people who had "an understanding of China and the Chinese cultural context 'so deep that it is intuitive,' to understand the Chinese people's 'mixed feelings, of love and hate about the West, to understand Chinese history, language, the influence of Confucianism, Buddhism and Taoism, this is especially important if you are in the consumer goods industry,'" said Warren Liu, former vice president of development at KFC China and author of the book KFC in China: Secret Recipe for Success. This leadership team recommended that KFC follow a strategy of localization: offering local Chinese food options on the menu to appeal to local tastes. For example, instead of serving coleslaw, KFC offers bamboo shoots and lotus roots. Likewise, it sells a sandwich in the style that Peking duck is served, simply substituting fried chicken for the duck. The extent of KFC's product localization is extensive, from preserved Sichuan pickle and shredded pork soup to a Chinese-style porridge called congee for breakfast.

KFC's promotional marketing is similarly steep in Chinese culture. As Yu Cui and Zhang Ting explain, "China is a society with relatively high collectivism, where people have a high sense of identity to the traditional culture and traditional food. Since the family members in China often share the similar value and most Chinese people consider that it is necessary to keep on the wonderful family traditions, such as respecting, loving and supporting the elderly, helping others, friendship between individuals and so on. Thus, many advertisements of KFC in recent years try to reveal the background of common Chinese families."

KFC emphasizes speed and convenience rather than chicken. "Choosing to eat at fast food restaurants like KFC doesn't necessarily indicate a desire for Western flavors," said Sun Min, a local government official who eats at KFC because speed and convenience are his top priorities when choosing a place to eat.

Selecting the right place or location for its outlets is also important for convenience, and KFC is opening stores at a pace of nearly one a day in China, to be close to wherever its customers are. KFC also developed its distribution system quickly, right from the start, and its parent, Yum! Brands, owns those distribution centers. Owning its own distribution centers lets Yum! Brands grow it restaurants efficiently as it expands into 402 cities in China.

For the future, David Novak, CEO of Yum! Brands (which owns Pizza Hut and Taco Bell in addition to KFC), said he envisions eventually having more than twenty thousand restaurants in China. “We’re in the first inning of a nine-inning ball game in China,” Novak told investors in a conference call in February 2010.

Why is Starbucks so expensive in China?

Imagine walking into Starbucks and discovering that your grande latte cost $27. You'd probably think that the world's coffee supply had suddenly vanished. Or that you'd traveled by time machine many decades into the future.

These inflated prices gives you a pretty good idea of the relative cost (adjusted to per capita income) of what a Chinese person pays for the drink. China's per capita income, at about $7,200, is around five and a half times less than the American figure. Yet at a Starbucks in Beijing, a grande latte goes for about $4.80—or a dollar more than what it costs in the United States. A simple beverage of espresso and steamed milk is pretty damned expensive in China.

Considering this, it's a small miracle that Starbucks is still in business there at all. But in fact, the Seattle-based caffeine empire's China operations are thriving. Last December, Bloomberg reported that Starbucks plans to double its China workforce by 2015, adding hundreds of new stores in cities across the country in the process. The company even expects China to become its second largest market—behind just the United States—by this time.

In fairness, per capita income is a crude way to measure the buying power of Starbucks' actual customer base: The majority of its stores are located in China's large, coastal cities, where most people earn a lot more than the nationwide per capita average. Nevertheless, it's striking that in a developing country, one lacking an indigenous coffee-drinking culture, so many people are willing to pay a premium for Starbucks products. Logically, wouldn't it make sense for Starbucks to drop its prices a little in order to attract even more customers?

The problem with this idea is pretty simple—operating a Starbucks store in China is expensive. For a country where labor is cheap—Starbucks baristas in Beijing make much less than their American counterparts—this may seem counterintuitive. But labor is just one component that goes into making a grande latte

What's expensive are the logistics. The coffee beans Starbucks brews in its Beijing stores, as well as other materials like cups and mugs, don't cost any more to import in China than in the United States. The problem is getting these materials from point A to point B. "Transporting coffee beans from, say, Colombia to the port of Tianjin is about the same as transporting them from Colombia to the port of Los Angeles," says David Wolf, a public relations professional and expert in Chinese business. "It's getting them from the port in Tianjin to the store in Beijing that's expensive." China has invested billions of dollars over the years to improve its port and transportation infrastructure, but the combination of taxes, fees, and middle-men add to logistics costs—which are then passed on to customers in the form of marked-up Frappuccinos and lattes.

So if Starbucks is so expensive in China, why do so many people go there? Most cities in the country have coffee shops that provide a roughly similar cup of coffee—and similarly comfortable atmosphere—at much lower prices. How does Starbucks make it work?

One major issue is culture. Since the Chinese economy opened up to import products in the late 1970s, these goods acquired a certain cachet with image-conscious consumers. "Traditionally foreign products were regarded as better-made, higher-status, and simply nicer," Fei Wang, a Washington, DC-based consultant who grew up in

Wuhan, told me. "A person's social standing was defined by the objects they own." Far from acting as a deterrent, high prices actually enticed customers who wanted to show off their new affluence; put another way, purchasing a good like a cup of coffee at a premium was a good way to obtain "face" in business or personal relationships. And Starbucks had the good fortune of entering the country at a time when coffee drinking became fashionable among hip, young Chinese consumers.

There are signs, however, that Chinese preferences for high-priced, imported goods may be waning. With the rise of e-commerce—and more frequent foreign travel—Chinese consumers have begun to feel that they're paying too much for simple pleasures like a cup of coffee. "After living in America for awhile I was shocked at how expensive Starbucks was when I went back to China," says Wang. This trend appears to be happening across other industries, too: A disgruntled shopper told the Wall Street Journal's Laurie Burkitt that it simply wasn't "worth shopping in China anymore."

Could the Starbucks allure fade in China, as the country's once-non-existent coffee shop market matures? Probably not anytime soon. The company has proven adept at adding local touches in its Chinese stores, such as green tea flavored coffee drinks and collectible mugs, and has shown a flexibility that has eluded other foreign companies hoping to capitalize on the market. Eventually, though, Chinese customers may decide that a latte is just a latte—and the no-name place down the street is more than good enough.

5 ways Starbucks is different In China

It might seem risky for a coffee company to expand so aggressively in a culture of tea-drinkers. But Starbucks has altered its stores and products to adapt to local tastes and the strategy appears to be working.

The company's same-store sales grew 7% in the region for the most recent quarter and it's planning to open 500 new locations in China by the end of the year, which would make China Starbucks' second largest market outside the U.S.

Here's a few ways that Starbucks is doing things differently in China:

1. The stores are bigger with more seating space. "Unlike Americans, who can't cope without a morning cup of joe, most Chinese customers don't just grab and go," writes Violet Law in the Global Post. "Instead, coffee shops here are a destination. People sit back and chat with friends and family. Some come to meet with clients or do business."

   While most Starbucks stores in the U.S. are hectic and bustling, Chinese consumers seek out Starbucks to "nurse their drinks and lose themselves in their laptops... enjoying tranquility that's usually elusive in teeming China," Law writes.

2. The coffee is more expensive. Starbucks charges up to 20% more for its coffee products in China compared to other markets. The Chinese state media has attacked Starbucks for this practice, but the company says the prices are due to the higher costs of doing business in the country.

3. Starbucks stores in China offer a menu of Chinese teas and treats like mooncakes.But one of the best-selling item in the region right now is actually a Strawberry Cheesecake Frappucino, which is topped with a cream cheese whipped cream, graham cracker crumbles, and strawberry syrup. The Frappuccino "set instant records for the top-selling limited-time Frappuccino offering ever," Starbucks chief operating office Troy Alstead said on a recent earnings call.

4. The food is labeled with the country where it was imported from to address Chinese consumers' concerns about food safety.

5. Starbucks management makes an effort to get to know employees' families."Starbucks has...factored in family dynamics and expectations in China, where success can be judged by the title on one's business card," the company said in a statement. "Family forums have been held for parents of store partners to hear managers discuss gratifying career paths at Starbucks."

The Four Ps

As we saw in the opening case, KFC has had great success in China after a first failed attempt. Why did KFC try again after its first failure? For the same reason that most companies market their products globally. Specifically, companies expand internationally to reach more customers, gain higher profit opportunities, balance sales across countries in case one country experiences problems, and compete with other brands that are expanding internationally and with global firms in their home markets.

Reaching new consumers is often the main reason for international expansion. The rising standards of living in the developing world, especially BRICS countries (i.e., Brazil, Russia, India, China and South Africa) mean billions of new consumers. In fact, 80 percent of the world's population lives in emerging-market countries. Companies based in the mature economies of the West are attracted by the potential for double-digit growth in emerging markets.

What is the best way to reach those international customers? You begin with the core of marketing knowledge—the four Ps—product, price, promotion, and place. While you likely learned this framework in your marketing class, it is important to recognize how this essential tool will help you think about marketing in the context of international business. In a flat world, the answers to questions about the four Ps are all the same; however, because the world is not that flat, country differences will have important implications for how product, price, promotion, and place play out when an organization takes its offerings across borders.

Product

The first P—product—refers to any physical good or intangible service that is offered for sale. For example, the product could be physical, like a laser printer, or it could be a service, like printing or photocopying services. The product could also be access to information, such as stock-market reports. Given the differences between countries (e.g., language, culture, laws, and technology standards), a company's products may need to be adapted to different countries. Some products, like Coca-Cola or Starbucks coffee, need little, if any, modification. Nevertheless, even these companies create product variations to suit local tastes. For example, Starbucks introduced a green tea Frappuccino in China. The new flavor was very successful there. We will learn more about product standardization and customization later on.

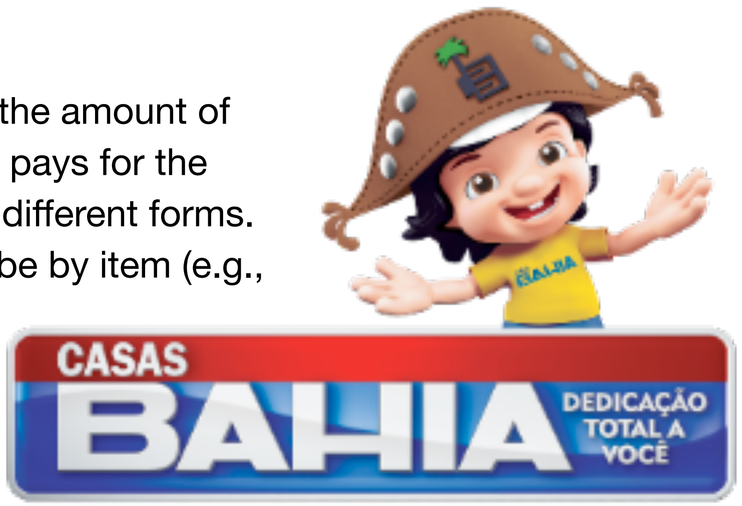
Casas Bahia

Some consumers in developing countries are very poor. Often called the bottom of the pyramid (BOP) on income scales, they are the four billion people who live on less than $2 a day. Would you market products to these people? Surprisingly, the answer may be yes in many instances. According to C. K. Prahalad, BOP consumers are a viable market segment to target. The key is having the right market mix of product, price, promotion, and place. Let us see how it works.

Casas Bahia is a retailer in Brazil that sells appliances and furniture. It successfully sells to the BOP. In fact, 45 percent of its appliance and furniture products are sold to BOP consumers. First, consider product. You might think that a refrigerator is a luxury item for these consumers. In a tropical country like Brazil, however, a refrigerator becomes more of a necessity. Second, price: obviously, keeping costs low is key. Casas Bahia does this by buying products in huge volumes to get huge discounts. It has built large warehouses capable of storing much more inventory than a typical retailer would, in order to handle the large volumes. However, low prices alone are not enough, as Walmart learned in its failed expansion into Brazil. Indeed, 70 percent of Casas Ba-

Price

The second P—price—is the amount of money that the consumer pays for the product. Pricing can take different forms. For example, pricing can be by item (e.g., a can of corn), by volume (e.g., gasoline), by subscription (e.g., monthly cable service), by usage (e.g., cell-phone minutes), or by performance (e.g., paying more for overnight delivery versus two-day delivery).



Let us spend a little more time on price, because pricing has even more nuances when applied to international products. For example, emerging-market countries often have a less-developed financial system and limited credit available to local consumers and businesses. Some of the biggest challenges in selling to emerging markets involve making the product affordable. In Brazil, 26 percent of the population lives below the poverty line. However, companies have devised ways to help even the poorest consumers afford products. Let us see how Casas Bahia has succeeded in selling to the bottom-of-the-pyramid (BOP) consumers in Brazil.

Promotion

The third P—promotion—refers to all the activities that inform and encourage consumers to buy a given product. Promotions include advertising (whether print, broadcast radio, television, online, billboard, poster, or mobile), coupons, rebates, and personal sales. Like products, promotions are often customized to a country to appeal to local sensibilities. One obvious mistake to avoid is a language translation that misses the nuances of native speakers. For example, a straight translation of Clairol's "Mist Stick" curling iron into German misses the nuance that "mist" in German is slang for manure. Likewise, Coors' "turn it loose" slogan, when translated into Spanish, is interpreted by some locals as "suffer from diarrhea. Regulations in Germany prohibited discounts, free gifts, or money-back guarantees with purchase. When US clothier Lands' End expanded into Germany, it was taken to court for its guarantee that "If you're not satisfied with any item, simply return it to us at any time for an exchange or refund of its purchase price.

Place

The final P—place—refers to the location at which a company offers its products for sale. The place could be a small kiosk in a village, a store in town, or an online website. Place poses a particular challenge when selling internationally. Many of the things we take for granted in the United States—national retailers, grocery stores, and extensive railways and roadways to reach them—aren't prevalent everywhere.

Products reach consumers through a channel of distribution, which is a series of firms or individuals who facilitate the movement of the product from the producer to the final consumer. The shortest channel, called the direct channel, consists of just the producer and the consumer. In this case, the consumer buys directly from the producer, such as when you buy an apple from a local farmer. An indirect channel, in contrast, contains one or more intermediaries between the consumer and the producer. These intermediaries include distributors, wholesalers, agents, brokers, and retailers. In international business, the number of intermediaries can expand due to the regulations affecting import and export across national boundaries. Agents, brokers, international freight forwarders, and trading companies may get involved. Then, once a company's product is in the foreign country, that country may have its own wholesalers who get involved. The firm must pay all these intermediaries for their services, which increases the cost of the product. Firms must raise prices or accept lower margins when confronting these added channel costs.

Even when sales are direct, as with Internet sales, place differences can affect marketing. For example, as mentioned previously, laws in Germany prohibit retailer Lands' End from advertising its unconditional money-back guarantee because returns are allowed only up to 14 days.

The marketing mix

The four Ps together form the marketing mix. Because the four Ps affect each other, marketers look at the mix of product, price, promotion, and place. They fine-tune and adjust each element to meet the needs of the market and to create the best outcome for the company. Promotion has an impact on the other Ps because a product's price, for example, may be lowered during a promotional event. Likewise, holding a special promotional event like a two-for-one deal on a product impacts place, because the company must ensure that it supplies stores with enough product to meet the anticipated demand. Finally, the promotion might affect the product's packaging, such as bundling a shampoo and conditioner together.

A company's marketing mix will often be different for different countries based on:

- a country's culture and local preferences;
- a country's economic level;
- what a country's consumers can afford; and
- a country's distribution channels and media.

Market segmentation

Market segmentation is the process of dividing a larger market into smaller markets that share a common characteristic. The characteristics might be demographics, such as segments divided by age groups (e.g., 18 to 24-year-olds), genders, or household incomes. Segmentation can also be done on the basis of geographic location or by lifestyle (e.g., new moms of different ages might have more in common with each other than they have with identically aged non mothers.) The purpose of segmentation is to give the company a concrete vision of its customers, so that it can better understand how to market to that customer. Segmentation helps companies target their marketing efforts more effectively.

For example, geographic segmentation is important for language differences. Sometimes, the segmentation must be done even more granularly than at the country level. Some parts of Mexico, for instance, do not use Spanish as the primary language. Because of this, Walmart Mexico's stores in Juchitán conduct business in the local Zapotec tongue. Its female employees wear traditional skirts, and the morning company cheer is in Zapotec.

Each country may have its own cultural groups that divide the country or transcend national boundaries. For example, the northern coast of Colombia is culturally more similar to the Caribbean than it is to the interior of its own country because the Andes Mountains split the country into two regions: east and west. Historically, these regions had been cut off from each other.

Understanding your target customers

Foreign markets are not just copies of US markets; they require products suitable to the local population. Although European and developed country markets are more similar to the United States, emerging markets like the BRICS countries have important differences. Products must meet local needs in terms of cost, quality, performance, and features and, in order to be successful, a company must be aware of the interplay between these factors. Let us look at consumers in emerging countries to get a feel for these differences.

Rising middle class

The number of middle-class people in emerging countries has been growing, partly because of Western companies hiring low-cost labor (directly or through outsourcing agreements) in these regions. Providing jobs in these countries has improved household incomes. These fast-rising incomes, especially in urban areas, create vast new pools of disposable income. Eight of the ten largest cities in the world are in emerging markets. Their populations are young, and they're just beginning to adopt the full range of consumer goods found in the developed world.

In some cases, these middle-class consumers will buy more expensive branded goods, if the brands resonate with the interests of the local crowd. Consider the relative sales ratio of $60 Nike basketball shoes versus $120 Yao Ming–branded Nike basketball shoes. In the United States, sales might be 20 percent for the higher priced shoe. In mainland China, it might be 5 percent for the Yao Ming shoe due to cost; but in more prosperous Hong Kong, the sales might be 50 percent for the shoes Middle-class populations are reading about Western goods and want branded items, but pricing can be an issue depending on the local level of affluence.

Millionaires are everywhere

Just because the average income is much lower in emerging markets doesn't mean that no one can afford high-end luxury goods. Some automobile manufacturers, for example, track the number of millionaires in the country as an indicator of the very affluent segment. By recent estimates, China has approximately 477,000 millionaires Brazil has approximately 143,000, Russia has approximately 136,000, and India has approximately 126,000. These very high net-worth individuals explicitly want the same products that are sold in the West, not down-market versions. Specific cities in emerging-market countries may have a concentration of affluent consumers. In Monterrey, Mexico, for example, the costs of consumer goods are comparable to those of New York City.

Emerging markets for business customers

Business-to-business (B2B) opportunities also abound, as emerging-market businesses grow to serve export or internal markets. Just as with consumers, businesses in emerging markets are different from developed markets. For example, companies in emerging markets may be smaller and less sophisticated and may have lower budgets than their Western counterparts. They may lack the level of automation and information technology that prevails in the developed world. This is especially true in the retail industry. Many developing countries have a predominance of small mom-and-pop stores.

Global market research

Global market research includes understanding the market's culture and social trends, because these factors impact which products consumers will like and which advertising appeals will resonate with them.

Some of the same techniques of market research used in the United States can be applied internationally. For example, Procter & Gamble (P&G) uses a variety of focus-group testing and in-home research to understand why people buy the products they buy. P&G researchers watch how consumers use products and ask about what features they might want in the future. The company has learned from past experience that just because a product sells well in one market doesn't imply that it will sell well in another market. For example, although Bounty paper towels sell well in the United States, the European launch of Bounty paper towels did well in only two of twelve markets. Why? P&G quickly learned that Germans found the entire concept of paper towels to be too wasteful and, therefore, didn't buy them.

Dealing with gray and counterfeit markets

The gray market exists because of price discrepancies between different markets. For example, consumer packaged-goods companies may price their products higher in Austria than in the neighboring Czech Republic due to the Austrian citizens' higher income levels. As a result, Austrians might order their goods from Czech retailers and simply drive over the border to pick up the products. The goods in the Czech stores are legitimate and authentic, but the existence of this gray-market activity hurts the producer and their channel partners (e.g., distributors and retailers) in the higher-priced country.

U.S. Customs & Border Protection seizes more than $14M worth of fake handbags in L.A.

In contrast to gray markets, which are legitimate but—legally—in a gray area, counterfeit markets purposely deceive the buyer. For example, counterfeiters slightly alter the Sony logo to Bony in a way that makes it hard to distinguish without careful inspection.

Counterfeit markets hurt companies that have invested in building intellectual assets such as unique product designs, technological developments, costly media content, and carefully crafted brands. Together, these intellectual assets represent an investment of millions or billions of dollars. If a company's product, technology, or brand is counterfeited, both the company's reputation and financial security suffers. All of its channel partners (i.e., distributors, retailers, and licensing partners) are affected as well. For example, an executive traveling in Hong Kong saw unique styles of Nike shoes. When he asked about them, he was told the shoes were only available in size nine. This fact led him to realize that the shoes were probably prototype samples from a local factory that had been smuggled out of the factory to be sold. Some industries have tried to limit the scope of the counterfeiting and copying of DVDs through regionalized encoding, but even this is too easy to circumvent. That is why musical and entertainment giant Bertelsmann avoids expansion into emerging-market countries that have lax enforcement of intellectual property rights.

Counterfeiters may also tamper with branded products. For example, Intel processor chips vary in price based on their processing speed: the higher the speed, the higher the price of the chip. Counterfeiters buy (or steal) low-end chips, repaint a few numbers on them, and then sell them as high-end chips. The high-end chips sell for $100 or $200 more than the low-end chips. Customers looking for a bargain may unwittingly buy these chips. For Intel, these remarked chips not only cannibalize sales of the higher-margin, high-performance chips, but they also create higher warranty costs because customers turn to Intel when these chips fail. The counterfeiting can also damage the brand's reputation. To defeat counterfeiters, Intel implemented a long list of product-security measures. It replaced removable painted numbers with more-permanent, laser-etched numbers; developed retail packages with holograms and other hard-to-copy markings; and created software to detect any mismatch between the chip's internal rating and operating speed.

The previous section is taken from Saylor.org's *International Business, Chapter 14: Fundamentals of Global Marketing*.

Strategically, Intel executives debated whether to even use the Intel name on products at the low end of the spectrum that were sold in emerging markets. Not using the Intel name would prevent the low-priced goods from re-entering Western markets. The downside of that strategy, however, is less brand recognition in the developing country.

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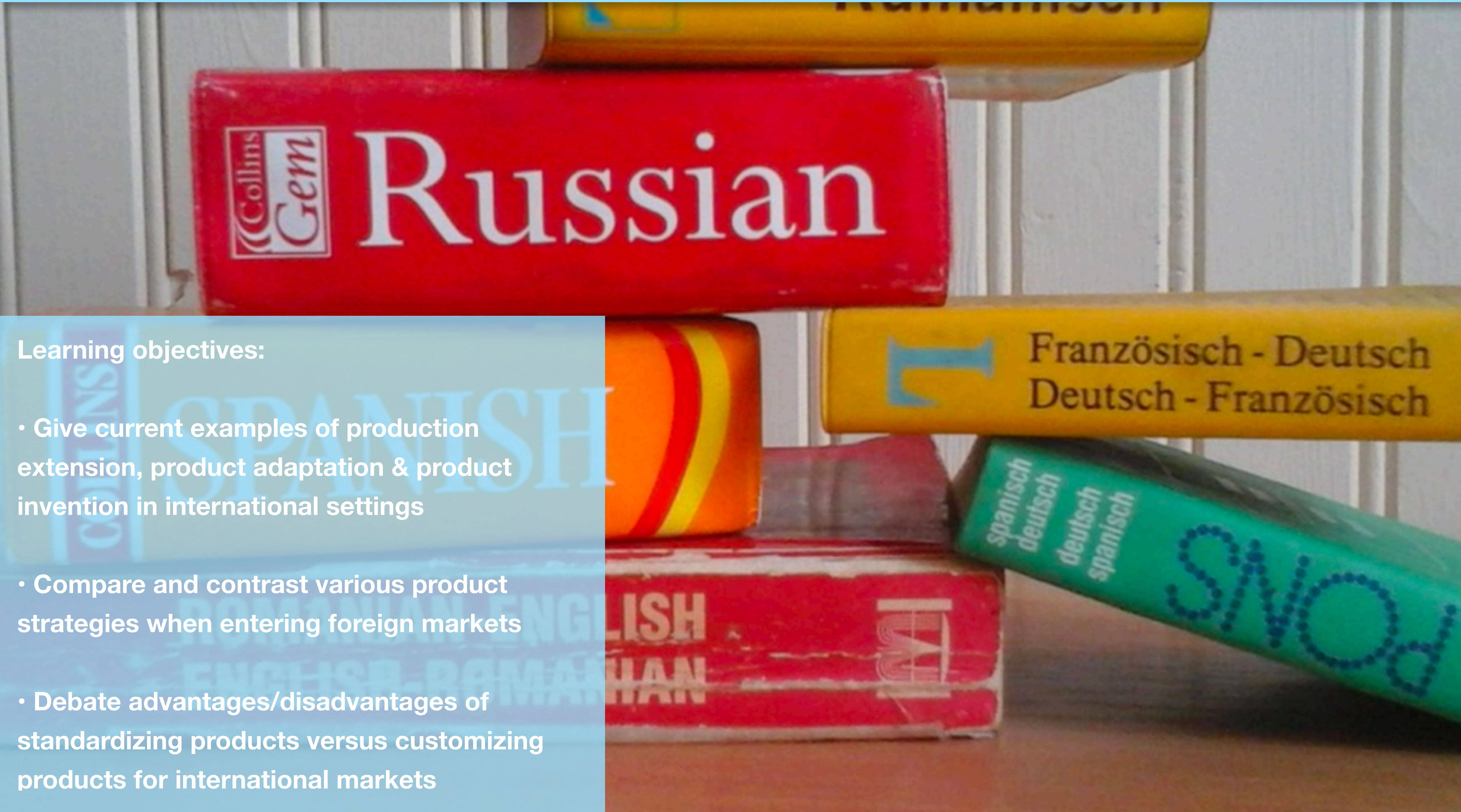
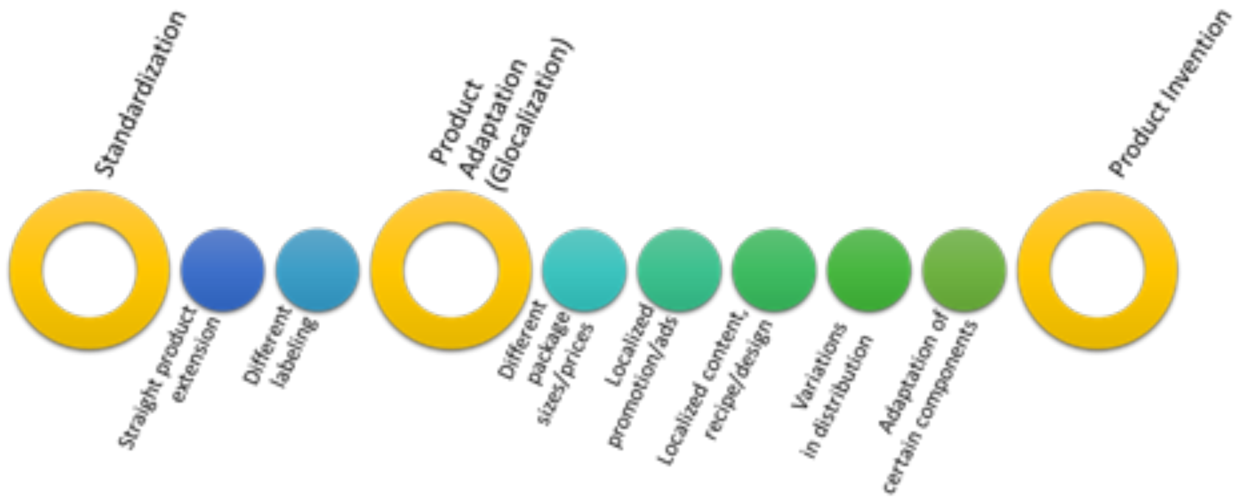
Chapter 4

Standardized or Customized Products



Learning objectives:

- Give current examples of production extension, product adaptation & product invention in international settings
- Compare and contrast various product strategies when entering foreign markets
- Debate advantages/disadvantages of standardizing products versus customizing products for international markets



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Standardized or customized products

International expansion would be much easier if foreign markets would accept products and services from a company's home market with no modification. But this is highly unlikely no matter how hard a company tries to establish their product as the standard. Forces as varies as consumer tastes and governmental restrictions force exporters to modify their products in order to reap the benefits of a global market. Companies deciding to market their products in different countries typically have a choice of three common strategies to pursue.

Straight product extension

The first is the straight product extension. This means taking the company's current products and selling them in other countries without making changes to the product. The advantages of this strategy are that the company does not need to invest in new research, development, or manufacturing. Changes may be made in packaging and labeling, but these are driven by local regulatory requirements. The disadvantages, however, are that its products may not be well suited to local needs and that the products may be more costly due to higher manufacturing and labor costs in the United States.

Product adaptation

The second strategy is product adaptation and refers to modifying the company's existing product in a way that makes it fit better with local needs. For example, when Procter & Gamble (P&G) introduced Tide laundry detergent in emerging markets like India, it changed the formulation to remove softeners. The reformulated Tide cost less than the original Tide. This change was important because price was an important factor in India where income levels were lower. Indian consumers were more able to afford the reformulated Tide.

Another way to localize a product is through packaging. Locally appropriate packaging does not just mean using the country's language. It also means creating packaging sizes that suit the country. For example, a company wanting to make its products more economical to less-wealthy countries may be tempted to sell larger, economy-sized packaging. However, emerging-market consumers often prefer smaller package sizes, even if that increases the cost-per-use. They tend to buy sachets of shampoo rather than economy-size bottles. These smaller sizes are also easier to transport to local villages or to store in smaller-sized homes.

Mobile-phone maker Nokia went a step further in localizing its phones to different markets. The company uses local designers to create mobile-phone handset models that are specifically appropriate for each country. For example, the handsets designed in India are dust resistant and have a built-in flashlight. The models designed in China have a touchscreen, stylus, and Chinese character recognition.

Local designers are more likely to understand the needs of the local population than headquarters-located designers do.

The examples of Tide and Nokia show how companies can create a version of their existing product tailored to specific countries.

Product invention: P&G diapers

The third strategy, product invention, is creating an entirely new product for the target market. In this strategy, companies go back to the drawing board and rethink how best to design a product for that country.

The first step in inventing a product for a new country market is to understand the key product characteristics needed to succeed in that market. For example, when P&G wanted to sell diapers in BRICS countries (i.e., Brazil, Russia, India, China, and South Africa), it started from square one. Rather than merely modifying the existing design, P&G engaged local knowledge and reconsidered all the key features of the design in the context of the needs of the emerging markets.

A major issue was price. To make the diaper affordable, P&G settled on an aggressive price target—each diaper should cost as much as one egg. However, the company also wanted a diaper that could uphold the P&G brand name. At first, the designers thought that the lower-cost product needed to do everything that the current developed-world product did. Further discussions refined and narrowed the definition so that P&G could meet the cost target without damaging the brand.

P&G designers debated features such as absorbency, color, fit, and packaging to find a design that was acceptable on cost targets, acceptable to emerging-market consumers, and acceptable as a P&G-branded product. The designers considered materials and how they could avoid using high-paid, specialized suppliers. Some characteristics, such as packaging, could be adjusted to meet local cost standards. In other cases, a characteristic was nonnegotiable—such as corporate social-responsibility issues. For example, P&G wanted to ensure that none of the suppliers to its diaper business used child labor. In the end, P&G succeeded by understanding both the critical elements of the brand and the emerging-market customers' expectations.

Nuances of product extension, adaptation & invention

The product-adaptation strategy is easier for firms to execute than product invention. Nonetheless, even product adaptation requires understanding the local market well. Consider Ford Motor Company's missteps in adapting its mid-priced car model to the Indian market. Ford realized that it needed to lower the cost of its car to make it more affordable to Indian consumers. Ford brought a team of designers together in Detroit and tasked them with figuring out how to reduce the cost of the car. The designers looked at removing nonessential elements. The first feature to go was air conditioning. Next, the team decided to remove power windows in the back, keeping them only in the front. These and other such tweaks brought the total cost of the car down from $20,000 to $15,000. Reducing the cost by 25 percent is notable, but unfortunately, the design team lacked vital local knowledge about India. First, even though the price of the car was lower, the $15,000 price point in India is still way above what the middle class can afford. The Indians who can afford a $15,000 car are the very rich. Second, the very rich in India who can afford to pay $15,000 for a car can also afford (and will have) a chauffeur. Remember the clever idea of removing the air conditioning and the power windows in the back? The consequence is that the chauffeur is the only one who gets a breeze. Given the sweltering summer temperatures and traffic congestion in Indian cities, you can guess that the Ford car didn't sell.

Country-of-origin effect

The country-of-origin effect refers to consumers using the country where the product was made as a barometer for evaluating the product. Their perceptions of the country influence whether they will perceive the product favorably or unfavorably. That perception influences consumers' purchasing decisions. For example, France is known for its wines and luxury goods. Wines from Chile may be just as good and more affordably priced, but consumers may perceive French wines to be better due to the country-of-origin effect. In the 1960s, "Made in Japan" was a signal of low quality, but over time Japan has changed that perception through a dedicated focus on high quality. Specifically, Japan adopted Total Quality Management (TQM) which is a set of management practices initially introduced to Japan by W. Edwards Deming. The focus of TQM is increasing quality and reducing errors in production or service delivery. TQM consists of systematic processes, planning, measurement, continuous improvement, and customer satisfaction. These days, "made in Japan" is viewed positively, but "made in China" faces more of a stigma. Likewise, consumers in Colombia don't want products that are made in Colombia. A similar problem happens with Mercedes-Benz—Mercedes-Benz cars assembled in Egypt have much lower resale value than those assembled in Germany. In these cases, local assembly in Egypt might be taken as a sign of inferior quality.

Reverse innovation: how designing for emerging economies brings benefits back home

Increasingly, marketing and innovation are directly linked. Reverse innovation means designing a product for a developing country and bringing that innovation back to the home country. Creating new products and services for developing countries requires radical innovation and opens new opportunities in developed-world markets as well. For example, GE Healthcare sells sophisticated medical-imaging devices around the world. Historically, GE has sold these high-end machines in emerging economies like India. Only 10 percent of Indian hospitals can afford a $10,000 electrocardiogram (ECG) machine. Reaching the other 90 percent of the market takes more than simply cutting a few costs. It requires radical innovation and an in-depth understanding of local conditions.

One important local fact to know is that most Indians live in rural areas. That means they do not have a local hospital to visit. Therefore, medical equipment needs to go to them, and no rural health care clinic is going to lug a $10,000 ECG machine into the field even if it could afford the device. Achieving the goal of a lightweight, reliable, simple-to-use ECG device took radical rethinking. GE built such a device that could fit in a shoulder bag or backpack. The device has a built-in replaceable printer and costs only $500. In addition, because the device would be used in rural locations with scant access to electricity, GE designed a battery that could do 500 ECGs on one charge. To make it easy to use, GE designed the device to have only three buttons. Finally, just because the device is inexpensive does not mean it's dumb. GE installed professional-level analysis software to aid rural doctors.

With its new portable ECG device, GE has unlocked a completely new market in developing countries. Beyond that, GE has also opened up new opportunities back home—and that is the reverse innovation side of the story. How? The portable ECG machine with a $500 price tag is ideal for use in ambulances, saving lives of accident victims in developed countries as well. Cheap, portable, and easy-to-use devices are desirable in any country.

The previous section is taken from Saylor.org's *International Business*, Chapter 14: Standardized or Customized Products.

Factors affecting the decision to standardize versus to adapt

The decision to modify your product to fit foreign market needs may be a big one. Frantz Manufacturing, in Sterling, IL, understands this issue all too well. Frantz manufacturers ball bearings for commercial applications, primarily in rollers for conveyer belts. The economy of scale of manufacturing ball bearings is significant enough that Frantz has a strong international potential for selling its ball bearings manufactured in the Midwest throughout the world. However, the size of each ball bearing must fit the technical specifications of the product in which it will be incorporated. Sizes of ball bearings are measured using inches in the U.S., so all of Frantz's ball bearings are sized with inch measurements. But because most of the world's product specifications use the metric standard, any market using the metric system was not a potential market for Frantz. The cost of adapting all the tooling and machinery to the metric standard seemed prohibitive, but the company was able to justify the investment when their non-metric international sales were strong enough to justify expanding into metric markets.

Kevin Taylor, previous Worldwide Director of International Sales, explains their decision: "In the past our only sales were to foreign companies that had engineered to American standards. Adapting our product removed that barrier. When dealing with an engineered product to be used in an engineered system, adaptation is imperative. Sales are otherwise next to impossible!"

Should a company always adapt their products or services? Are there instances when adaptation is not the right strategy? When adaptation is required, how far should a company adapt? These are some of the questions I will address in this section. This issue can most easily be understood by first identifying the pressures on manufacturers, and service providers to either adapt or standardize. As you review these pressures, identify the ones that apply to your company.

Pressures to adapt your product or service

Differences in technical standards. As clearly shown in the example of Frantz Manufacturing, sometimes the requirements for a product are so absolute that no sales are available in certain foreign markets unless you adapt. One of the most common examples is the difference in technical standards between countries and markets. Issues that most often come to mind are the metric versus non-metric standard and differences in electrical voltage. Other common issues include cell phone standards, electrical plugs, and environmental standards. For service providers, differences in management, legal, and accounting standards create challenges. Often the difference in technical standards is in the form of government testing or quality standards.

Variations in consumer behavior, needs, and ability to buy. The strongest influence on your decision to adapt your product or service may be from the consumer. Even low prices and high quality won't create a demand for your product if it doesn't address the needs of the consumer. Factors influencing consumer behavior and needs are as varied as differences in climates and geography, and basic behavioral activities such as driving patterns and cooking techniques. Socioeconomic differences will also have a major impact, from religion and education to attitudes towards wealth. Language differences also are a consumer-based force. These factors will exert significant pressure on a exporter to modify its product or service.

The tremendous variations in consumer tastes and socioeconomic demographics would seem to make the job of product adaptation enormous, and for global companies like Procter & Gamble, it has been a major part of their international marketing challenge. However, a converge of tastes and other factors help mitigate this otherwise overwhelming force.

Government standards and restrictions. Another important driving force behind product and service adaptation is the role of foreign governments. Often local environmental, product safety, or labeling requirements dictate the need for product modification. In some markets, especially those still practicing fairly closed international trade policy, import barriers, such as government tariffs on foreign imports necessitate product modification. A manufacturer may need to ship partially built products or assemblies so more locally manufactured content can be added in the foreign market to avoid excessive tariffs. The European CE Mark and requirements for ISO registration are other examples of government-led initiatives that may impose a product modification strategy on the exporter.

Pressures to standardize your product or service

Pressures to standardize are generally internal issues rather than external pressures. Depending on your industry, these pressures may be significantly stronger than any pressures to adapt.

Economies of scale in R&D and production. Many industries are characterized by having significant entry barriers associated with R&D or production. Pharmaceutical companies have massive R&D budgets for testing and developing various drugs, only a few of which may become commercially viable. Automobile manufacturers make equally massive investments in manufacturing technologies in the never-ending pursuit of achieving highly differentiated products at low cost. Both types of companies represent industries where the upfront and ongoing investments are so large that new start-up companies are the exception rather than the norm.

The key to profitability for firms with massive R&D and production costs is the economy of scale achieved through high volumes of sales. Once the R&D or production-technology costs are spread across the products sold, the cost impact is minimal enough to keep the product competitive. But the benefit from economics of scale isn't available if the products have to be continually modified. It is the very nature of their standardization that makes the high upfront costs possible.

It it weren't for the pressures forced on manufacturers by the foreign marketplace, the goal of all international companies would be to completely standardize their products to achieve maximum economies of scale. Depending on your product or service and the industry, your cost structure may push you to standardize as much as the market will allow.

Product usage dictates standardization: In some industries, customers must have product standardization in order to use the product. A good example would be a microprocessor manufacturer such as Intel. Its customers, computer manufacturers, have established manufacturing facilities throughout the world. A computer manufacturer in France may produce computers in Malaysia and Brazil for shipment to the U.S. Intel may ship the manufactured processors made in the U.S., Ireland, or Israel, among others. The computer manufacturer must be sure that each processor is identical and it relies on the standardization of product. Due to the nature of international manufacturing, industrial goods tend to be more standardized than consumer goods.

Company size forces standardization: In some cases, the cost of adaptation may simple be too high for a company given its size and maturity. This is especially true of companies with products that require large capital expenditures on R&D or manufacturing in order to comply with foreign market needs.

Country of origin effect: The consumers' perception of where a product originates and the impact of that perception on their purchasing behavior is referred to as country of origin effect. For example, Swiss made watches enjoy a worldwide reputation of quality. For some consumers, the label “Swiss Made” is a significant incentive to purchase a watch over a similarly featured non-Swiss watch. In cases where part of the product culture lies with the perceived country of origin (even if the product is actually not produced in the home country of the manufacturer) the manufacturer may pursue a policy of standardization in order to maximize its home-country image. For example, U.S. cigarette manufactures benefit from the standardized use of U.S. tobacco.

Converging tastes: Emerging markets with less exposure to foreign goods tend to favor locally produced products that reflect their local tastes. But as the market opens up to foreign goods and media and the per capita income of the consumers increase to match that of more developed countries there is a convergence of tastes towards global standards. An example would be a country that goes from only preferring fresh vegetables and meats to eventually using microwave ovens and demanding more frozen products. This results in consumers demanding more products reflecting global standardized tastes, which would be a force to standardize products.

When Standardization Is Preferred

- High costs of adaptation
- Primarily Industrial products as opposed to consumer product
- Convergence and similar taste in diverse country markets
- Predominant use in urban environments
- Centralized management
- Scale of economies in production, R&D, and marketing is a priority
- Consumer mobility is high if positive home-country image (country of origin) effect exists

When Adaptation Is Advantageous

- Differences in technical standards , sophistication and regulations
- Primarily consumer and personal use products
- Variation in consumer needs
- Variation in condition of use
- Variation in ability to buy, differences in income levels
- Variation is skill levels of users, raw material availability, and government requirements.

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To adapt or standardize

Rarely will a company fully adapt or standardize a product. The cost to adapt is in most cases too expensive and too disruptive of a company’s global goals. Likewise, a pursuit of total standardization for the sake of cost control results in a product offering too narrow to be internationally viable. A company will probably follow a path of compromise between both extremes. Like so many business decisions, it becomes one of balancing the risk versus the reward offered by each option. The company’s long term international strategy and goals will also guide a company through these difficult decisions. A very aggressive international expansion plan with a product or service that requires adaptation will no doubt need strong support of an adaptation program.

There is no right or wrong; it depends on the circumstances of the company, its products and services, and the foreign markets. What would be wrong would be to ignore international differences and to strictly impose your U.S. product or service. This disregard for foreign customers will not be productive. A company that embraces a customer oriented attitude will find it has made the right decision.

Product or service selection

What if a company has more than one important product or service it sells? How should the company select which products or services to internationalize?

Generally, a company will first export the product or service that is most linked to its competitive advantage – meaning that product or services which really makes the company unique. This is simply because it will be its most competitive products or services that will first get the attention of foreign buyers. This may be the product with the highest quality or most features. It may be one which offers disruptive technology – technology highly innovative in the industry. The least expensive product may also be the best choice. For a service industry, it is likely the key service most identified with the company.

Another consideration is linked back to the topic of standardization versus adaptation. If the costs associated with adapting a product are too high, a company may select a product which requires less adaptation.

Regardless of how a company chooses which products or services to globalize, the key point is that when a company has a wide-range of offerings, it will likely start with a more limited range of products or services when expanding internationally.

The previous section is taken from *The Global Entrepreneur: Taking Your Business International* by James F. Foley.

Mini Case: P&G's success in reverse innovation, Vicks Cough Syrup with Honey Jana (2009, March 31)

A new over-the-counter medicine from Vicks that has recently become popular in Switzerland is not as new as it seems. The product, Vicks Cough Syrup with Honey, is really just the latest incarnation of a product that Vicks parent company, Procter & Gamble (P&G), initially created for lower-income consumers in Mexico and then "trickled up" to more affluent markets.

Until recently, affluent consumers in the United States and Western Europe could afford the latest and greatest in everything. Now, with purchasing power dramatically reduced because of the global recession, budget items once again make up a growing portion of total sales in many product categories.

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Chapter 5

Global Pricing

Learning objectives:

- Understand the sellers' objectives in making pricing decisions
- List the alternative approaches to determining global prices
- Explain penetration and skimming in global pricing
- Explain the meaning of pricing from the buyer, seller, and society
- Understand the alternative pricing approaches available to the manager
- Understand the effect that tariffs have on pricing

Global pricing

Firms rely on price to cover the cost of production, to pay expenses, and to provide the profit incentive necessary to continue to operate the business. We might think of these factors as helping organizations to: (a) survive, (b) earn a profit, (c) generate sales, (d) secure an adequate share of the market, and (e) gain an appropriate image

- **Survival:** It is apparent that most managers wish to pursue strategies that enable their organizations to continue in operation for the long term. So survival is one major objective pursued by most executives. For a commercial firm, the price paid by the buyer generates the firm's revenue. If revenue falls below cost for a long period of time, the firm cannot survive.

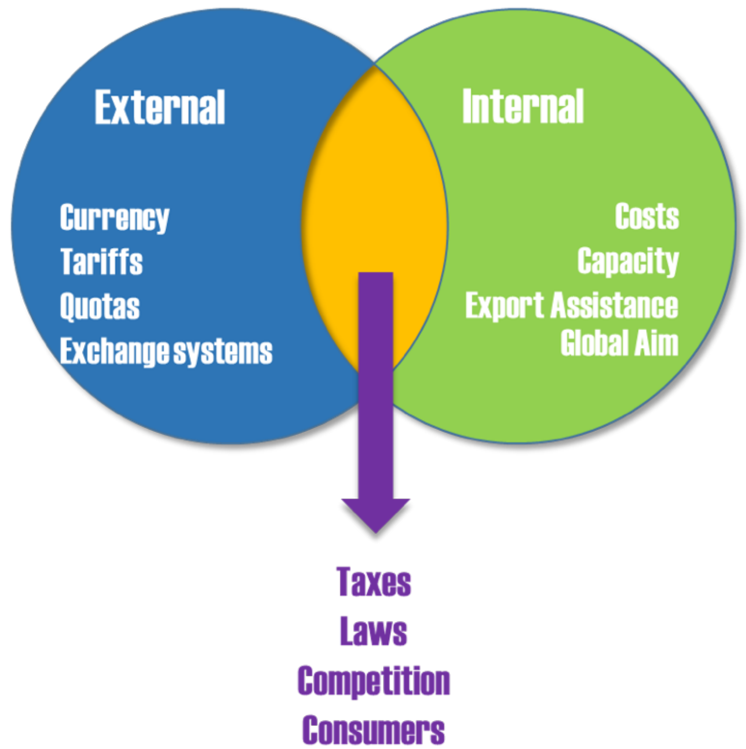
- **Profit:** Survival is closely linked to profitability. Making a USD 500,000 profit during the next year might be a pricing objective for a firm. Anything less will ensure failure. All business enterprises must earn a long term profit. For many businesses, long-term profitability also allows the business to satisfy their most important constituents–stockholders. Lower-than-expected or no profits will drive down stock prices and may prove disastrous for the company.

- **Sales:** Just as survival requires a long-term profit for a business enterprise, profit requires sales. As you will recall from earlier in the text, the task of marketing management relates to managing demand. Demand must be managed in order to regulate exchanges or sales. Thus marketing management's aim is to alter sales patterns in some desirable way.

- **Market share:** If the sales of Safeway Supermarkets in the Dallas-Fort Worth metropolitan area of Texas, USA, account for 30 per cent of all food sales in that area, we say that Safeway has a 30 per cent market share. Management of all firms, large and small, are concerned with maintaining an adequate share of the market so that their sales volume will enable the firm to survive and prosper. Again, pricing strategy is one of the tools that is significant in creating and sustaining market share. Prices must be set to attract the appropriate market segment in significant numbers.

- **Image:** Price policies play an important role in affecting a firm's position of respect and esteem in its community. Price is a highly visible communicator. It must convey the message to the community that the firm offers good value, that it is fair in its dealings with the public, that it is a reliable place to patronize, and that it stands behind its products and services.

At its basic level, pricing is the process of determining what a company will receive in exchange for its products. As one of the four "Ps" in the marketing mix, pricing is the only revenue generating element. Several factors affect the global pricing of a product, e.g., manufacturing cost, market place, competition, market condition, and quality of product, distribution channels, country factors and company factors. International pricing decisions also need to take account of tariffs, quotas, local taxes, subsidies, grants, currency exchange, rates, local purchasing power, local business and consumer characteristics. See Figure 8.1



Prices can be used both to set values and provide signals in international markets. From a customer's point of view, value is the sole justification for price. Many times customers lack an understanding of the cost of materials and other costs that go into the making of a product. But those customers can understand what that product does for them in the way of providing value. It is on this basis that customers make decisions about the purchase of a product.

Effective pricing meets the needs of consumers and facilitates the exchange process. It requires that marketers understand that not all buyers want to pay the same price for products, just as they do not all want the same product, the same distribution outlets, or the same promotional messages. Therefore, in order to effectively price products, markets must distinguish among various market segments. The key to effective pricing is the same as the key to effective product, distribution, and promotion strategies. Marketers must understand buyers and price their products according to buyer needs if exchanges are to occur. However, one cannot overlook the fact that the price must be sufficient to support the plans of the organization, including satisfying stockholders. Price charged remains the primary source of revenue for most businesses.

Although making the global pricing decision is usually a marketing decision, making it correctly requires an understanding of both the customer and society's view of price as well. In some respects, price setting is the most important decision made by a business. A price set too low may result in a deficiency in revenues and the demise of the business. A price set too high may result in poor response from customers and, unsurprisingly, the demise of the business. The consequences of a poor pricing decision, therefore, can be dire. We begin our discussion of pricing by considering the perspective of the customer.

The customer's view of price

A customer can be either the ultimate user of the finished product or a business that purchases components of the finished product. It is the customer that seeks to satisfy a need or set of needs through the purchase of a particular product or set of products. Consequently, the customer uses several criteria to determine how much they are willing to expend in order to satisfy these needs. Ideally, the customer would like to pay as little as possible to satisfy these needs. Therefore, for the business to increase value (i.e. create the competitive advantage), it can either increase the perceived benefits or reduce the perceived costs. Both of these elements should be considered elements of price. To a certain extent, perceived benefits are the mirror image of perceived costs. For example, paying a premium price (e.g. USD 650 for a piece of Lalique crystal) is compensated for by having this exquisite work of art displayed in one's home. Other possible perceived benefits directly related to the price-value equation are status, convenience, the deal, brand, quality, choice, and so forth. Many of these benefits tend to overlap. Thus, providing value-added elements to the product has become a popular strategic alternative. Computer manufacturers now compete on value-added components such as free delivery setup, training, a 24-hour help line, trade-in, and upgrades.

Perceived costs include the actual dollar amount printed on the product, plus a host of additional factors. As noted, these perceived costs are the mirror-opposite of the benefits. When finding a gas station that is selling its highest grade for USD 0.06 less per gallon, the customer must consider the 16 mile (25.75 kilometer) drive to get there, the long line, the fact that the middle grade is not available, and heavy traffic. Therefore, inconvenience, limited choice, and poor service are possible perceived costs. Other common perceived costs include risk of making a mistake, related costs, lost opportunity, and unexpected consequences, to name but a few. A new cruise traveler discovers he or she really does not enjoy that venue for several reasons–e.g. he or she is given a bill for incidentals when she leaves the ship, has used up her vacation time and money, and receives unwanted materials from this company for years to come. In the end, viewing price from the customer's perspective pays off in many ways. Most notably, it helps define value–the most important basis for creating a competitive advantage.

Price from a societal perspective

Price, at least in dollars and cents, has been the historical view of value. Derived from a bartering system (exchanging goods of equal value), the monetary system of each society provides a more convenient way to purchase goods and accumulate wealth. Price has also become a variable society employs to control its economic health. Price can be inclusive or exclusive. In many countries, such as Russia, China, and South Africa, high prices for products such as food, health care, housing, and automobiles, means that most of the population is excluded from purchase. In contrast, countries such as Denmark, Germany, and Great Britain charge little for health care and consequently make it available to all.

The Global marketer's view of price

Price is important to global marketing, because it represents marketers' assessment of the value customers see in the product or service and are willing to pay for a product or service. A number of factors have changed the way marketers undertake the pricing of their products and services.

- Local competition puts pressure on the global firms' pricing strategies. Many local-made products are high in quality and compete in global markets on the basis of lower price for good value.

- Local competitors often try to gain market share by reducing their prices. The price reduction is intended to increase demand from customers who are judged to be sensitive to changes in price.

- New products are far more prevalent today than in the past. Pricing a new product can represent a challenge, as there is often no historical basis for pricing new products. If a new product is priced incorrectly, the marketplace will react unfavorably and the "wrong" price can do long-term damage to a product's chances for marketplace success.

- Technology has led to existing products having shorter marketplace lives. New products are introduced to the market more frequently, reducing the "shelf life" of existing products. As a result, marketers face pressures to price products to recover costs more quickly. Prices must be set for early successes including fast sales growth, quick market penetration, and fast recovery of research and development costs.

Global pricing approaches

Global pricing decisions can be based on a number of factors, including cost, demand, competition, value, or some combination of factors. However, while many marketers are aware that they should consider these factors, pricing remains somewhat of an art. For purposes of discussion, we categorize the alternative approaches to determining price as follows: (a) cost-oriented pricing; (b) demand-oriented pricing; and (c) value-based approaches.

Cost-oriented pricing: cost-plus and mark-ups

The cost-plus method, sometimes called gross margin pricing, is perhaps most widely used by marketers to set price. The manager selects as a goal a particular gross margin that will produce a desirable profit level. Gross margin is the difference between how much the goods cost and the actual price for which it sells. This gross margin is designated by a per cent of net sales. The per cent selected varies among types of merchandise. That means that one product may have a goal of 48 per cent gross margin while another has a target of 33.5 per cent or 2 per cent.

A primary reason that the cost-plus method is attractive to marketers is that they do not have to forecast general business conditions or customer demand. If sales volume projections are reasonably accurate, profits will be on target. Consumers may also view this method as fair, since the price they pay is related to the cost of producing the item. Likewise, the marketer is sure that costs are covered.

A major disadvantage of cost-plus pricing is its inherent inflexibility. For example, department stores have often found difficulty in meeting competition from discount stores, catalog retailers, or furniture warehouses because of their commitment to cost-plus pricing. Another disadvantage is that it does not take into account consumers' perceptions of a product's value. Finally, a company's costs may fluctuate so constant price changing is not a viable strategy.

When middlemen use the term mark-up, they are referring to the difference between the average cost and price of all merchandise in stock, for a particular department, or for an individual item. The difference may be expressed in dollars or as a percentage. For example, a man's tie costs USD 4.60 and is sold for USD 8. The dollar mark-up is USD 3.40. The mark-up may be designated as a per cent of selling price 0r as a per cent of cost of the merchandise. In this example, the mark-up is 74 per cent of cost (USD 3.40/USD 4.60) or 42.5 per cent of the retail price (USD 3.40/USD 8).

There are several reasons why expressing mark-up as a percentage of selling price is preferred to expressing it as a percentage of cost. One is that many other ratios are expressed as a percentage of sales. For instance, selling expenses are expressed as a percentage of sales. If selling costs are 8 per cent, this means that for each USD 100,000 in net sales, the cost of selling the merchandise is USD 8,000. Advertising expenses, operating expenses, and other types of expenses are quoted in the same way. Thus, there is a consistency when making comparisons in expressing all expenses and costs, including mark-up, as a percentage of sales (selling price).

Middlemen receive merchandise daily and make sales daily. As new shipments are received, the goods are marked and put into stock. Cumulative mark-up is the term applied to the difference between total dollars delivered cost of all merchandise and the total dollar price of the goods put into stock for a specified period of time. The original mark-up at which individual items are put into stock is referred to as the initial mark-up.

Maintained mark-up is another important concept. The maintained mark-up percentage is an essential figure in estimating operating profits. It also provides an indication of efficiency. Maintained mark-up, sometimes called gross cost of goods, is the difference between the actual price for which all of the merchandise is sold and the total dollar delivered cost of the goods exclusive of deductions. The maintained mark-up is typically less than the initial mark-up due to mark-downs and stock shrinkages from theft, breakage, and the like. Maintained mark-up is particularly important for seasonal merchandise that will likely be marked-down substantially at the end of the season.

Although this pricing approach may seem overly simplified, it has definite merit. The problem facing managers of certain types of businesses such as retail food stores is that they must price a very large number of items and change many of those prices frequently. The standard mark-up usually reflects historically profitable margins and provides a good guideline for pricing.

Certainly costs are an important component of pricing. No firm can make a profit until it covers its costs. However, the process of determining costs and then setting a price based on costs does not take into consideration what the customer is willing to pay at the marketplace. As a result, many companies that have set out to develop a product have fallen victim to the desire to continuously add features to the product, thus adding cost. When the product is finished, these companies add some percentage to the cost and expect customers to pay the resulting price. These companies are often disappointed, as customers are not willing to pay this cost-based price.

Break-even analysis

A somewhat more sophisticated approach to cost-based pricing is the break-even analysis. The information required for the formula for break-even analysis is available from the accounting records in most firms. The break-even price is the price that will produce enough revenue to cover all costs at a given level of production. Total cost can be divided into fixed and variable (total cost = fixed cost + variable cost). Recall that fixed cost does not change as the level of production goes up or down. The rent paid for the building to house the operation might be an example. No cost is fixed in the long run, but in the short run, many expenses cannot realistically be changed. Variable cost does change as production is increased or decreased. For example, the cost of raw material to make the product will vary with production.

A second shortcoming of break-even analysis is it assumes that variable costs are constant. However, wages will increase with overtime and shipping discounts will be obtained. Third, break-even assumes that all costs can be neatly categorized as fixed or variable. Where advertising expenses are entered, break-even analysis will have a significant impact on the resulting break-even price and volume.

Target rates of return

Break-even pricing is a reasonable approach when there is a limit on the quantity which a firm can provide and particularly when a target return objective is sought. Assume, for example, that the firm with the costs illustrated in the previous example determines that it can provide no more than 10,000 units of the product in the next period of operation. Furthermore, the firm has set a target for profit of 20 per cent above total costs. Referring again to internal accounting records and the changing cost of production at near capacity levels, a new total cost curve is calculated. From the cost curve profile, management sets the desirable level of production at 80 per cent of capacity or 8,000 units. From the total cost curve, it is determined that the cost for producing 8,000 units is USD 18,000. 20 per cent of USD 18,000 is USD 3,600. Adding this to the total cost at 8,000 units yields the point at that quantity through which the total revenue curve must pass. Finally, USD 21,600 divided by 8,000 units yields the price of USD 2.70 per unit; here the USD 3,600 in profit would be realized. The obvious shortcoming of the target return approach to pricing is the absence of any information concerning the demand for the product at the desired price. It is assumed that all of the units will be sold at the price which provides the desired return.

It would be necessary, therefore, to determine whether the desired price is in fact attractive to potential customers in the marketplace. If break-even pricing is to be used, it should be supplemented by additional information concerning customer perceptions of the relevant range of prices for the product. The source of this information would most commonly be survey research, as well as a thorough review of pricing practices by competitors in the industry. In spite of their shortcomings, break-even pricing and target return pricing are very common business practices.

Demand-oriented pricing

Demand-oriented pricing focuses on the nature of the demand curve for the product or service being priced. The nature of the demand curve is influenced largely by the structure of the industry in which a firm competes. That is, if a firm operates in an industry that is extremely competitive, price may be used to some strategic advantage in acquiring and maintaining market share. On the other hand, if the firm operates in an environment with a few dominant players, the range in which price can vary may be minimal.

Value-based pricing

If we consider the three approaches to setting price, cost-based is focused entirely on the perspective of the company with very little concern for the customer; demand-based is focused on the customer, but only as a predictor of sales; and value-based pricing focuses entirely on the customer as a determinant of the total price/value package. Marketers who employ value-based pricing might use the following definition: “It is what you think your product is worth to that customer at that time.” Moreover, it acknowledges several marketing/price truths:

- To the customer, price is the only unpleasant part of buying.
- Price is the easiest marketing tool to copy.
- Price represents everything about the product

Still, value-based pricing is not altruistic. It asks and answers two questions: (a) what is the highest price I can charge and still make the sale? and (b) am I willing to sell at that price? The first question must take two primary factors into account: customers and competitors. The second question is influenced by two more: costs and constraints. Let us discuss each briefly.

Many customer-related factors are important in value-based pricing. For example, it is critical to understand the customer buying process. How important is price? When is it considered? How is it used? Another factor is the cost of switching. Have you ever watched the television program “The Price is Right”? If you have, you know that most consumers have poor price knowledge. Moreover, their knowledge of comparable prices within a product category —e.g. ketchup—is typically worse. So price knowledge is a relevant factor. Finally, the marketer must assess the customers’ price expectations. How much do you expect to pay for a large pizza? Color TV? DVD? Newspaper? Swimming pool? These expectations create a phenomenon called “sticker shock” as exhibited by gasoline, automobiles, and ATM fees.

A second factor influencing value-based pricing is competitors. As noted in earlier chapters, defining competition is not always easy. Of course there are like-category competitors such as Toyota and Nissan. We have already discussed the notion of pricing above, below, and at the same level of these direct competitors. However, there are also indirect competitors that consumers may use to base price comparisons. For instance, we may use the price of a vacation as a basis for buying vacation clothes. The cost of eating out is compared to the cost of groceries. There are also instances when a competitor, especially a market leader, dictates the price for everyone else. Weyerhauser determines the price for lumber. Kellogg establishes the price for cereal.

If you are building a picnic table, it is fairly easy to add up your receipts and calculate costs. For a global corporation, determining costs is a great deal more complex. For example, calculating incremental costs and identifying avoidable costs are valuable tasks. Incremental cost is the cost of producing each additional unit. If the incremental cost begins to exceed the incremental revenue, it is a clear sign to quit producing. Avoidable costs are those that are unnecessary or can be passed onto some other institution in the marketing channel. Adding costly features to a product that the customer cannot use is an example of the former. As to the latter, the banking industry has been passing certain costs onto customers.

Another consideration is opportunity costs. Because the company spent money on store remodeling, they are not able to take advantage of a discounted product purchase. Finally, costs vary from market-to-market as well as quantities sold. Research should be conducted to assess these differences.

Although it would be nice to assume that a business has the freedom to set any price it chooses, this is not always the case. There are a variety of constraints that prohibit such freedom. Some constraints are formal, such as government restrictions in respect to strategies like collusion and price-fixing. This occurs when two or more companies agree to charge the same or very similar prices. Other constraints tend to be informal. Examples include matching the price of competitors, a traditional price charged for a particular product, and charging a price that covers expected costs.

Ultimately, value-based pricing offers the following three tactical recommendations:

- Employ a segmented approach toward price, based on such criteria as customer type, location, and order size.
- Establish highest possible price level and justify it with comparable value.
- Use price as a basis for establishing strong customer relationships

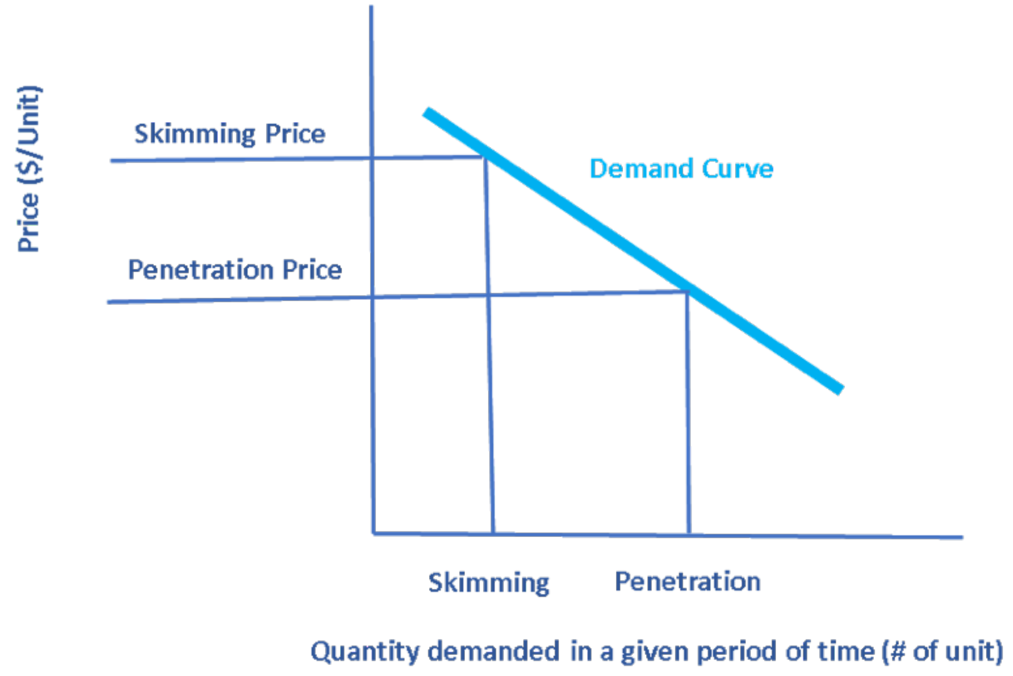
Penetration & skimming pricing

Penetration pricing is usually used in the introductory stage of a new product's life cycle, and involves accepting a lower profit margin and to price relatively low. Such a strategy should generate greater sales and establish the new product in the market more quickly. Price skimming involves the top part of the demand curve. Price is set relatively high to generate a high profit margin and sales are limited to those buyers willing to pay a premium to get the new product.

Penetration pricing can be used to achieve market share as a competitive strategy to achieve market leadership. Other times, it can also be used to increase market and sales growth. For example, when Sony was developing the Walkman in 1979, although a retail price of ¥50,000 ($249) was required to achieve breakeven. However, a price of ¥35,000 ($170) was needed to attract the youth market segment. Although after a long processes of cost cutting, a breakeven price of ¥40,000 was achieved, Chairman Akio Morita insisted on a retail price of ¥33,000 ($165) to commemorate Sony's 33rd anniversary. Sony also used this approach when its camcorder market became very competitive with price competition from Samsung, Hitachi and Panasonic. Another example is Google's penetration pricing strategy, where they offered their Google Checkout service at a break-even price or at a loss, trying to gain market share against Paypal.

Which strategy is best depends on a number of factors. A penetration strategy would generally be supported by the following conditions: price-sensitive consumers, opportunity to keep costs low, the anticipation of quick market entry by competitors, a high likelihood for rapid acceptance by potential buyers, and an adequate resource base for the firm to meet the new demand and sales.

A skimming strategy is most appropriate when the opposite conditions exist. A premium product generally supports a skimming strategy. In this case, "premium" does not just denote high cost of production and materials; it also suggests that the product may be rare or that the demand is unusually high. An example would be a USD 500 ticket for the World Series or an USD 80,000 price tag for a limited-production sports car. Having legal protection via a patent or



Skimming generates a higher profit margin while penetration generates greater volume.

copyright may also allow for an excessively high price. Intel and their Pentium chip possessed this advantage for a long period of time. In most cases, the initial high price is gradually reduced to match new competition and allow new customers access to the product.

A skimming strategy may be used when the company is the only marketer of a new or innovative product, so as to maximize profits until competition forces a lower price (Li and Li 2008). Several electronic products that were very innovative during their introduction, such as DVRs, CR payers, Flat Screen TVs, were priced very high during the initial introduction phase; then the prices dropped steeply. This strategy can also be used when their markets have only two income levels: the super-rich and the very poor, as when Johnson & Johnson priced their diapers in Brazil before the arrival of P&G. As the company's cost structure will not allow the setting of a low enough price for the low income segment, the company will cater to the wealthier segment using a premium price.

Currency fluctuations & global pricing

Briefly, currency is any form of money in general circulation in a country. What exactly is a foreign exchange? In essence, foreign exchange is money denominated in the currency of another country or —now with the euro—a group of countries. Simply put, an exchange rate is defined as the rate at which the market converts one currency into another.

Any company operating globally must deal in foreign currencies. It has to pay suppliers in other countries with a currency different from its home country's currency. The home country is where a company is headquartered. The firm is likely to be paid or have profits in a different currency and will want to exchange it for its home currency. Even if a company expects to be paid in its own currency, it must assess the risk that the buyer may not be able to pay the full amount due to currency fluctuations.

If you have traveled outside of your home country, you may have experienced the currency market—for example, when you tried to determine your hotel bill or tried to determine if an item was cheaper in one country versus another. In fact, when you land at an airport in another country, you're likely to see boards indicating the foreign exchange rates for major currencies. For example, imagine you're on vacation in Thailand and the exchange rate board indicates that the Bangkok Bank is willing to exchange currencies at the following rates (see the following figure). GBP refers to the British pound; JPY refers to the Japanese yen; and HKD refers to the Hong Kong dollar, as shown in the following figure. Because there are several countries that use the dollar as part or whole of their name, this chapter clearly states "US dollar" or uses US$ or USD when referring to American currency.

Currency /Baht	Banknotes Buy	Banknotes Sell
USD	31.67	32.32
GBP	50.19	51.80
Euro	41.74	43.00
JOY	36.56	39.01

This chart tells us that when you land in Thailand, you can use 1 US dollar to buy 31.67 Thai baht. However, when you leave Thailand and decide that you do not need to take all your baht back to the United States, you then convert baht back to US dollars. We then have to use more baht—32.32 according to the preceding figure—to buy 1 US dollar. The spread between these numbers, 0.65 baht, is the profit that the bank makes for each US dollar bought and sold. The bank charges a fee because it performed a service—facilitating the currency exchange. When you walk through the airport, you'll see more boards for different banks with different buy and sell rates. While the difference may be very small, around 0.1 baht, these numbers add up if you are a global company engaged in large foreign exchange transactions.

Companies, investors, and governments want to be able to convert one currency into another. A company's primary purposes for wanting or needing to convert currencies is to pay or receive money for goods or services. Imagine you have a business in the United States that imports wines from around the world. You'll need to pay the French winemakers in euros, your Australian wine suppliers in Australian dollars, and your Chilean vineyards in pesos. Obviously, you are not going to access these currencies physically. Rather, you'll instruct your bank to pay each of these suppliers in their local currencies. Your bank will convert the currencies for you and debit your account for the US dollar equivalent based on the exact exchange rate at the time of the exchange.

Understand how to determine exchange rates

How to quote a currency

There are several ways to quote currency, but let's keep it simple. In general, when we quote currencies, we are indicating how much of one currency it takes to buy another currency. This quote requires two components: the base currency and the quoted currency. The quoted currency is the currency with which another currency is to be purchased. In an exchange rate quote, the quoted currency is typically the numerator. The base currency is the currency that is to be purchased with another currency, and it is noted in the denominator. For example, if we are quoting the number of Hong Kong dollars required to purchase 1 US dollar, then we note HKD 8 / USD 1. (Note that 8 reflects the general exchange rate average in this example.) In this case, the Hong Kong dollar is the quoted currency and is noted in the numerator. The US dollar is the base currency and is noted in the denominator. We read this quote as "8 Hong Kong dollars are required to purchase 1 US dollar." If you get confused while reviewing exchanging rates, remember the currency that you want to buy or sell. If you want to sell 1 US dollar, you can buy 8 Hong Kong dollars, using the example in this paragraph.

Direct currency quote & indirect currency quote

Additionally, there are two methods—the American terms and the European terms—for noting the base and quoted currency. These two methods, which are also known as direct and indirect quotes, are opposite based on each reference point. Let's understand what this means exactly.

The American terms, also known as US terms, are from the point of view of someone in the United States. In this approach, foreign exchange rates are expressed in terms of how many US dollars can be exchanged for one unit of another currency (the non-US currency is the base currency). For example, a dollar-pound quote in American terms is USD/GP (US$/£) equals 1.56. This is read as "1.56 US dollars are required to buy 1 pound sterling." This is also called a direct quote, which states the domestic currency price of one unit of foreign currency. If you think about this logically, a business that needs to buy a foreign currency needs to know how many US dollars must be sold in order to buy one unit of the foreign currency. In a direct quote, the domestic currency is a variable amount and the foreign currency is fixed at one unit.

Conversely, the European terms are the other approach for quoting rates. In this approach, foreign exchange rates are expressed in terms of how many currency units can be exchanged for a US dollar (the US dollar is the base currency). For example, the pound-dollar quote in European terms is £0.64/US$1 (£/US$1). While this is a direct quote for someone in Europe, it is an indirect quote in the United States. An indirect quote states the price of the domestic currency in foreign currency terms. In an indirect quote, the foreign currency is a variable amount and the domestic currency is fixed at one unit.

A direct and an indirect quote are simply reverse quotes of each other. If you have either one, you can easily calculate the other using this simple formula:

direct quote = 1 / indirect quote.

To illustrate, let's use our dollar-pound example. The direct quote is US$1.56 = 1/£0.64 (the indirect quote). This can be read as

1 divided by 0.64 equals 1.56.

In this example, the direct currency quote is written as US$/£ = 1.56.

While you are performing the calculations, it is important to keep track of which currency is in the numerator and which is in the denominator, or you might end up stating the quote backward. The direct quote is the rate at which you buy a currency. In this example, you need US$1.56 to buy a British pound.

Exchange fluctuations and global prices

The strengthening or weakening of a home (exporting) country's currency vis-à-vis that of the host (foreign) country, can have far-reaching effects on the price setting in the foreign country, as well as other elements of the global marketer's marketing strategy. For example, if the value of the U.S. dollar relative to the euro was U.S.$1 to 1.8315 euros in 2001, and U.S.$1 to 0.8499 euros in 2003, then the exchange rate U.S.$1 to 1.8315 euros is said to be stronger for the US dollar, and the exchange rate U.S.$1 to 0.8499 euros is said to be weaker for the US dollar. Similarly, if the value of the U.S. dollar relative to the Indian Rupee was U.S.$1 to INR 50 in 2001, and U.S.$1 to INR 70 in 2018, then the exchange rate U.S.$1 to INR 50 is said to be weaker for the US dollar than the exchange rate U.S.$1 to INR 70. A weaker exchange rate (e.g. U.S.$1 to 0.8499 euros and U.S.$1 to INR 50) will fetch lesser money in terms of the foreign currency, while a stronger exchange rate will fetch more money in terms of the foreign currency.

When the home currency of the global marketer weakens, the exchange rates are supposed be favorable to the global marketer, because the home currency will fetch lesser in terms of the foreign currency, and hence the prices of the exported product in the foreign country's currency will come down. Therefore, the global marketer can cut prices in the foreign country, and hence, increase market share. On the other hand, the global marketer can also decide to maintain the higher prices, in which case the global marketer will see windfall revenue, and increased margins. Thus if the exchange rate of the US dollar relative to the Japanese Yen weakens (lesser Yen for each dollar), then it is good for US companies manufacturing their products in the US and selling them in Japan (e.g. Boeing, Caterpillar, GE). On the other hand, it is not a good pricing scenario for Japanese companies (e.g. Canon and Olympus) who manufacture and sell in Japan against their US competitors. This context is also unfavorable to American tourists who are shopping for cameras, because they would be paying in Yen, and their US dollars would get lesser Yen, relative to what it would have fetched if the US dollar was stronger.

When the domestic (home) currency of the US global marketer strengthens (e.g. U.S.$1 to 1.8315 euros and U.S.$1 to INR 70), where the US dollar will fetch more money in terms of the foreign currency, then this price situation is said to be bad for global marketers who manufacture their products in the US and sell them in the foreign (host) country, priced in the foreign currency. Although each dollar gets more in terms of the foreign currency, what it really means is that the US company will now get lesser dollars after conversion into the US dollar, for the same amount of foreign currency, after the exchange rate strengthening. Thus, the US company may not be able to cover its costs which are specified in US dollars. One strategy to overcome this effect is to manufacture or source their products in the host country, and maximize all expenditures in the local currency (remember, each dollar gets more local currency!).

Since the strengthening of the home (domestic) currency results in more foreign currency, this conversion results in higher prices, which are specified in the local currency. This is usually not a problem if the demand for a product is inelastic. Otherwise, the global marketer has to cut costs in his home country, or improve quality and service to make up for the increased price levels. A drastic strategy to counter this situation would be to absorb some of the costs, which will result in a reduced margin.

WHEN HOME CURRENCY IS WEAK
Stress price benefits Expand product line and add more costly features Shift sourcing to domestic market Exploit market opportunities in all markets Use full-costing pricing but employ marginal cost-pricing to penetrate new or competitive markets Speed repatriation of foreign-earned income and collections Minimize expenditures in local (host-country) currency Buy advertising, insurance, transportation and other services in domestic markets Bill foreign customers in their own currency
WHEN HOME CURRENCY IS STRONG
Engage in non-price competition by improving quality, delivery and after-sale service Improve productivity and engage in cost reduction Shift sourcing outside home country Give priorities to exports to countries with stronger currencies Trim profit margins and use marginal-cost pricing Keep foreign-earned money in host country; slow down collections Maximize expenditures in local (host-country) currency Buy needed services abroad and pay for them in local currency Bill foreign customers in the domestic currency

Tariffs & global pricing

A tariff is any tax or fee collected by a government. Two of the price effects of a tariff are worthy of emphasis. First, although a tariff represents a tax placed solely on imported goods, the domestic price of both imported and domestically produced goods will rise. In other words, a tariff will cause local producers of the product to raise their prices. Why?

When the price of imported goods rises due to the tariff, consumers will shift their demand from foreign to domestic suppliers. The extra demand will allow domestic producers an opportunity to raise output and prices to clear the market. In so doing, they will also raise their profit. Thus as long as domestic goods are substitutable for imports and as long as the domestic firms are profit seekers, the price of the domestically produced goods will rise along with the import price.

The average consumer may not recognize this rather obvious point. For example, suppose the United States places a tariff on imported automobiles. Consumers of U.S.-made automobiles may fail to realize that they are likely to be affected. After all, they might reason, the tax is placed only on imported automobiles. Surely this would raise the imports' prices and hurt consumers of foreign cars, but why would that affect the price of U.S. cars? The reason, of course, is that the import car market and the domestic car market are interconnected. Indeed, the only way U.S.-made car prices would not be affected by the tariff is if consumers were completely unwilling to substitute U.S. cars for imported cars or if U.S. automakers were unwilling to take advantage of a profit-raising possibility. These conditions are probably unlikely in most markets around the world.

The second interesting price effect arises because the importing country is large. When a large importing country places a tariff on an imported product, it will cause the foreign price to fall. The reason? The tariff will reduce imports into the domestic country, and since its imports represent a sizeable proportion of the world market, world demand for the product will fall. The reduction in demand will force profit-seeking firms in the rest of the world to lower output and price in order to clear the market.

The effect on the foreign price is sometimes called the terms of trade effect. The terms of trade is sometimes defined as the price of a country's export goods divided by the price of its import goods. Here, since the importing country's import good will fall in price, the country's terms of trade will rise. Thus a tariff implemented by a large country will cause an improvement in the country's terms of trade.

Selling to BOP

In 1998, Professors C. K. Prahalad and Stuart L. Hart defined the bottom of the pyramid (BOP) as the billions of people living on less than $2 per day.The BOP is estimated to comprise between four billion and five billion people. He proposes an alternative approach for the private sector to alleviate poverty by viewing the poor as producers, not consumers. This shift in view, is the way to alleviate poverty by raising the incomes of the poor.

In Prahalad and Hart's view, companies that understand the potential for commercial consumption at the BOP can open a new, potentially lucrative market that benefits the business as well as BOP consumers. By innovating to meet the needs of BOP customers, a company treats them with dignity and respect that previously was afforded only to the wealthy, Prahalad and Hart say.

Twelve principles of BOP innovation

Addressing the bottom of the pyramid requires a fresh managerial mind-set, summarized below in Prahalad's "12 Principles of BOP Innovation"—which are innovations themselves. In developed markets, Prahalad suggests that one may take the availability of electricity, telephones, credit, refrigeration, and other such amenities for granted. At the BOP, the infrastructure is much spottier and more hostile. Consumers may have to cope with frequent electric-power blackouts and brownouts. Credit may be extremely costly. Refrigeration may be unavailable. Products marketed to the bottom of the pyramid must be able to withstand such an environment.

Below are Prahalad's "12 Principles of BOP Innovation," along with examples of each.

1. Focus on value and on delivering performance for the price. The BOP consumer isn't interested merely in cheap prices but in getting the greatest possible performance for the price paid. It's extraordinary how low a price can be and still be highly profitable, if the seller is organized to deliver value. For example, doctors at India's Aravind Eye Care System, the world's largest eye-care business, perform hundreds of thousands of cataract surgeries each year. The prices range from $50 to $300 per surgery, including the hospital stay. Aravind is quite profitable, although 60 percent of its patients pay nothing.

2. Innovate. Products aimed at the BOP market can't simply be watered-down versions of developed-world products. Instead, products must be rethought to bring radically lower cost while at the same time having features that meet the BOP's highest needs. For example, Hindustan Unilever Limited (HUL), a Unilever subsidiary, developed a new molecular encapsulation technology to prevent iodized salt from losing its iodine before consumption. To test the efficacy of the technology, the researchers used radioactive tracing techniques pioneered by the Indian Atomic Energy Commission.

3. Make the solution scalable. When delivering high performance at affordable prices, profits must be generated through volume sales. The product itself must be low cost, but with four billion to five billion BOP customers across the world, scaling the operation is what will make the venture sustainable. Solutions should be scalable across borders.

4. Aim to conserve resources. BOP consumers cannot afford to waste resources. Per capita water consumption in the United States is almost 2,000 cubic meters per year, compared to less than 500 in China and less than 700 in India. The developed world's high standard of living is a water- and waste-intensive lifestyle. Innovations should emphasize conserving resources, recycling materials, and eliminating waste. Creating products for five billion people means designing the products in ways that can be environmentally sustainable. China's focus on electric cars rather than gasoline-powered cars reflects the reality that it's unlikely China could obtain the oil it would need for that many cars and that its extremely polluted cities could handle the additional exhaust fumes.

5. Identify functionality. BOP customers likely require different functionality than high-end consumers. For example, prosthetic legs developed for India's BOP consumers needed to meet some special requirements: consumers needed to be able to squat, sit cross-legged, and walk on rough ground. Dr. Pramod Karan Sethi and Ram Chandra developed the Jaipur Foot prosthetic for this purpose. The charity Bhagwan Mahaveer Viklang Sahayata Samiti, which is based in Jaipur, India, made them available for less than $30.

6. Think in terms of process innovations. One way to bring costs down dramatically is to standardize processes. That's how Aravind is able to bring down the costs of cataract surgery so dramatically. Aravind made the process highly standardized and trained young village women to prepare patients and handle postoperative care. Thus doctors focus exclusively on surgery and perform only cataract surgery—nothing else. This focused process lets one doctor and two technicians perform fifty surgeries per day.

7. Reduce the skills required to do the job. Design products and services suitable to people without skills. Voxiva, a Peruvian start-up, developed a system enabling health-care workers to diagnose illnesses such as smallpox by comparing a patient's lesions to a picture of a similar lesion. With this simplified diagnostic process, health-care workers don't require great skills to know when to call a doctor.

8. Educate consumers in the use of products. This may require collaborating with nongovernmental organizations (NGOs), governments, and others. HUL launched a program in some of India's village schools to promote the washing of hands with soap as a way to prevent the childhood diarrhea that kills two million children per year. HUL educated the children, who in turn educated their parents.

9. Design products and services to operate in very tough infrastructure environments. For example, when Indian conglomerate ITC built a network connecting Indian villages, it had to provide personal computers that could handle wide voltage fluctuations. ITC included surge suppressors and solar panels to give the system adequate, reliable electricity.

10. Make the interface simple and the learning curve short. In Mexico, the chain retailer Elektra uses automated teller machines (ATMs) with a fingerprint identification system so BOP consumers don't have to remember lengthy identification codes.

11. Innovate in distribution. Avon has built a Brazilian direct-sales business that delivers revenues of $1.7 billion annually.

12. Challenge assumptions. The Jaipur Foot and Aravind Eye Care System hospitals defy conventional wisdom about how (and at what price) it's possible to deliver health care to the poor.

Ethics in action

NextBillion.net began as an initiative of the World Resources Institute's Markets and Enterprise Program. The name refers to the next billion people to rise from the bottom of the pyramid into the middle class and connotes the next billion in profits that companies can make serving this market. The purpose of the site is to provide a source for news, analysis, research and discussion on development through enterprise and BOP ideas. In addition, the NextBillion.net website has a career center that posts jobs (consulting projects as well as full-time jobs and academic appointments). As the site states, its mission is to "highlight the development and implementation of business strategies that open opportunities and improve the lives of the world's approximately 4 billion low-income producers and consumers.

The previous section is taken from *Core Principles of International Marketing* from the Washington State. University's open texts, PB PRESSBOOKS.

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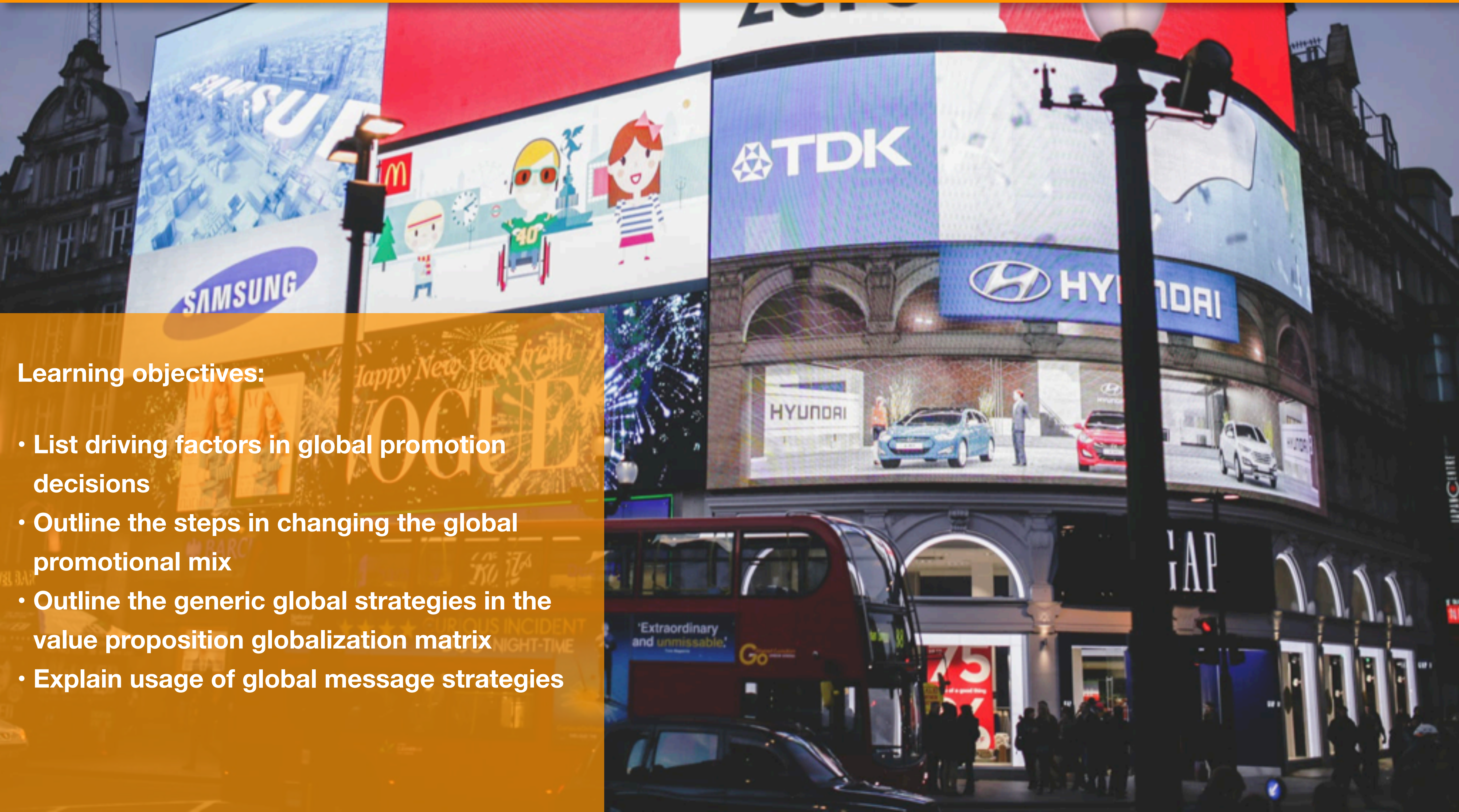
Chapter 6

Global Promotions



Learning objectives:

- List driving factors in global promotion decisions
- Outline the steps in changing the global promotional mix
- Outline the generic global strategies in the value proposition globalization matrix
- Explain usage of global message strategies

Marketing communications—the promotion P of the marketing mix—includes advertising, public relations, sales promotion, and personal selling. When a company embraces integrated marketing communications (IMC), it recognizes that the various elements of a company's communication strategy must be carefully coordinated. Advertising is a sponsored , paid message that is communicated through non-personal channels. Global advertising consists of the same advertising appeals, messages, artwork, and copy in campaigns around the world. The effort required to create a global campaign forces a company to determine whether or not a global market exists for its product. The trade-off between standardized and adapted advertising is often accomplished by means of pattern advertising, which can be used to create localized global advertising. Many advertising agencies are part of larger advertising organizations. Advertisers may place a single global agency in charge of worldwide advertising; it is also possible to use one or more agencies on a regional or local basis.

The starting point in ad development is the creative strategy, a statement of what the message will say. The people who create ads often seek a big idea that can serve as the basis for memorable, effective messages. The advertising appeal is the communication approach—rational or emotional—that best relates to buyer motives. Rational appeals speak to the mind: emotional appeals speak to the heart. The selling proposition is the promise that captures the reason for buying the product. The creative execution is the way an appeal or proposition is presented. Art direction and copy must be created with cultural considerations in mind. Perceptions of humor, male-female relationships, and sexual imagery vary in different parts of the world. Media availability varies considerably from country to country. When selecting media, marketers are sometimes as constrained by laws and regulations as by literacy rates.

A company utilizes public relations (PR) to foster goodwill and understanding among constituents both inside and outside the company. In particular, the PR department attempts to generate favorable publicity about the company and its products and brands. The PR department must also manage corporate communications when responding to negative publicity. The most important PR tools are press releases, media kits, interviews, and tours. Many global companies make use of various types of corporate advertising, including image advertising and advocacy advertising. Public relations is also responsible for providing accurate, timely information, especially in the event of a crisis.

Global promotion

Language is usually one element that is customized in a global promotional mix.

For global advertisers, there are four potentially competing business objectives that must be balanced when developing worldwide advertising: building a brand while speaking with one voice, developing economies of scale in the creative process, maximizing local effectiveness of advertisements, and increasing the company's speed of implementation. Global marketers can use the following approaches when executing global promotional programs: exporting executions, producing local executions, and importing ideas that travel.

Factors in global promotion

To successfully implement these approaches, brands must ensure their promotional campaigns take into how consumer behavior is shaped by internal conditions (e.g., demographics, knowledge, attitude, beliefs) and external influences (e.g., culture, ethnicity, family, lifestyle) in local markets.

- **Language:** The importance of language differences is extremely crucial in global marketing, as there are almost 3,000 languages in the world. Language differences have caused many problems for marketers in designing advertising campaigns and product labels. Language becomes even more significant if a country's population speaks several Colors: Colors also have different meanings in different cultures. For example, in Egypt, the country's national color of green is considered unacceptable for packaging because religious leaders once wore it. In Japan, black and white are colors of mourning and should not be used on a product's package. Similarly, purple is unacceptable in Hispanic nations because it is associated with death.

- **Values:** An individual's values arise from his or her moral or religious beliefs and are learned through experiences. For example, Americans place a very high value on material well-being and are much more likely to purchase status symbols than people in India. In India, the Hindu religion forbids the consumption of beef.
- **Business norms:** The norms of conducting business also vary from one country to the next. For example, in France, wholesalers do not like to promote products. They are mainly interested in supplying retailers with the products they need.
- **Religious beliefs:** A person's religious beliefs can affect shopping patterns and products purchased in addition to his or her values. In the United States and other Christian nations, Christmas time tends to be a major sales period. In other religions, significant religious holidays may or may not serve as popular times for purchasing products.

There are many other factors, including a country's political or legal environment, monetary circumstances, and technological environment that can impact a brand's promotional mix. Companies have to be ready to quickly respond and adapt to these challenges as they evolve and fluctuate in the market of each country.

Changing the global promotional mix

When launching global advertising, public relations or sales campaigns, global companies test promotional ideas using marketing research systems that provide results comparable across countries. The ability to identify the elements or moments of an advertisement that contribute to the success of a product launch or expansion is how economies of scale are maximized in marketing communications. Market research measures such as flow of attention, flow of emotion, and branding moments provide insight into what is working in an advertisement in one or many countries. These measures can be particularly helpful for marketers since they are based on visual, not verbal, elements of the promotion.

Considering these measures along with conducting extensive market research is essential to determining the success of promotional tactics in any country or region. Once brands discover what works (and what does not) in their promotional mix, those ideas can be imported by any other market. Likewise, companies can use this intelligence to modify various elements in their promotional mix that are receiving minimal or unfavorable response from global audiences.

Global communication strategies

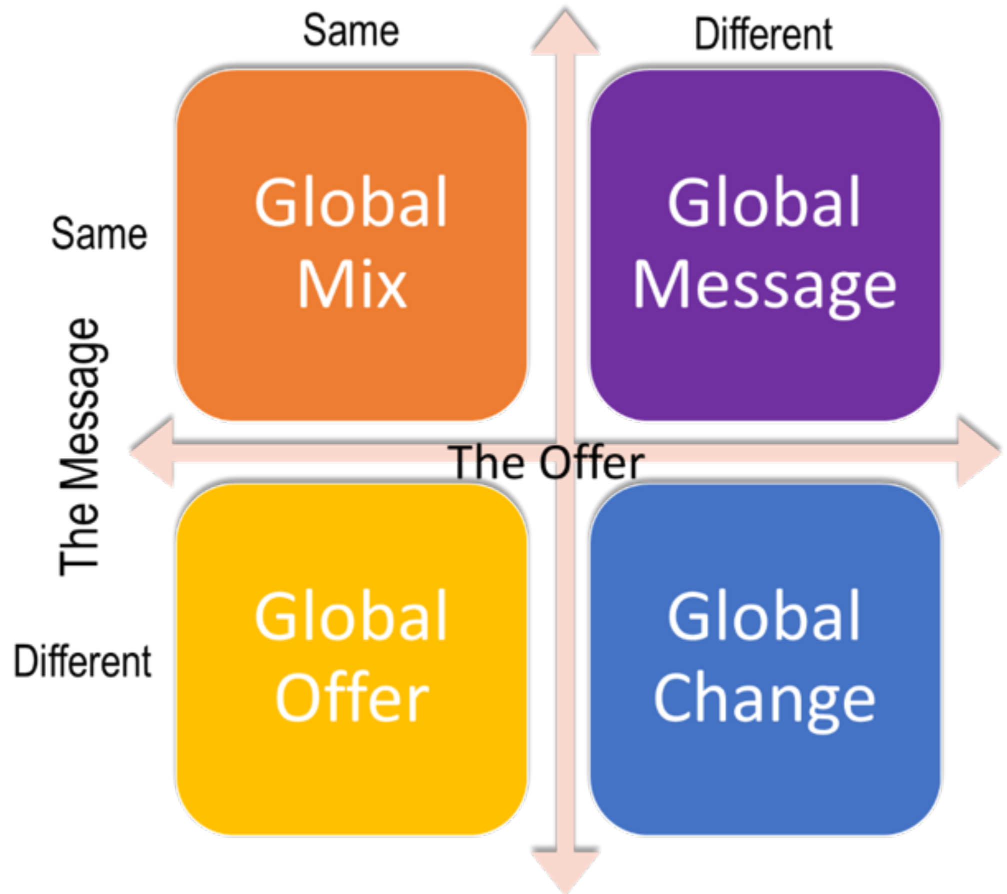
A useful construct for analyzing the need to adapt the offer and message (positioning) dimensions is the value proposition globalization matrix shown in Figure 11.1 "The Value Proposition Globalization Matrix", which illustrates four generic global strategies:

1. A pure aggregation approach (also sometimes referred to as a "global marketing mix" strategy) under which both the offer and the message are the same
2. An approach characterized by an identical offer (product/service aggregation) but different positioning (message adaptation) around the world (also called a "global offer" strategy)

3. An approach under which the offer might be different in various parts of the world (product adaptation) but where the message is the same (message aggregation; also referred to as a "global message" strategy)

4. A "global change" strategy under which both the offer and the message are adapted to local market circumstances

Global mix or pure aggregation strategies are relatively rare because only a few industries are truly global in all respects. They apply (a) when a product's usage patterns and brand potential are homogeneous on a global scale, (b) when scale and scope cost advantages substantially outweigh the benefits of partial or full adaptation, and (c) when competitive circumstances are such that a long-term, sustainable advantage can be secured using a standardized approach. The best examples are found in industrial product categories such as basic electronic components or certain commodity markets.



Global offer strategies are feasible when the same offer can be advantageously positioned differently in different parts of the world. There are several reasons for considering differential positioning. When fixed costs associated with the offer are high, when key core benefits offered are identical, and when there are natural market boundaries, adapting the message for stronger local advantage is tempting. Although such strategies increase local promotional budgets, they give country managers a degree of flexibility in positioning the product or service for maximum local advantage. The primary disadvantage associated with this type of strategy is that it could be difficult to sustain or even dangerous in the long term as customers become increasingly global in their outlook and confused by the different messages in different parts of the world.

Mini Case: Starwood's Branding in China, Palmeri and Balfour (2009, September 7)

Check into a Four Points Hotel by Sheraton in Shanghai and you will get all the perks of a quality international hotel: a free Internet connection, several in-house restaurants, a mah-jongg parlor, and an assortment of moon cakes, a Chinese delicacy. All this for $80 a night, about 20% less than the average cost of a room in Shanghai.

For travelers who associate the Sheraton brand with plastic ice buckets and polyester bedspreads in the United States, this may come as a surprise. Like Buick, Kentucky Fried Chicken (KFC), and Pizza Hut, Sheraton is one of those American names that, to some, seems past its prime at home, but it is still popular and growing abroad. The hotel brand has particular cachet in China, going back to 1985, when it opened the Great Wall Sheraton Hotel Beijing. Local developers still compete to partner with Sheraton's parent company—Starwood Hotels & Resorts Worldwide—to develop new properties. In the near future, the company will have more rooms in Shanghai than it does in New York.

Like many other U.S. companies experiencing pressure at home, Starwood sees China as one of its best hopes for growth. The company, which also owns the upscale St. Regis, Westin, W, and Le Meridien brands, expects much of this growth will come from outlying regions. Big cities such as Beijing now have plenty of rooms, thanks in part to the Olympics, but there is growing demand for business-class accommodation in second- and third-tier cities such as Jiangyin and Dalian. Lower construction costs and inexpensive labor mean the company's Chinese hotel owners can offer guests a lot more than comparably priced U.S. properties.

In recent years, the focus in China has shifted from international travelers to Chinese consumers. Starwood now asks its hotel staff to greet guests in Mandarin instead of English, which was long used to convey a sense of prestige. Many of its hotels do not label their fourth floors as such because four is considered an unlucky number.

Starwood is not alone in recognizing the potential of the Chinese market. Marriott International hopes to increase its China presence by 50%, to 61 hotels by 2014. And InterContinental Hotels Group, parent of Holiday Inn, plans to double the 118 hotels it has in China over the next 3 years.

One major perk Starwood can offer over local competitors is its extensive global network and loyalty perks. More than 40% of its Chinese business comes through its preferred-guest program, and Chinese membership in the program is increasing rapidly. But local customers are not particularly focused on accruing points to earn a free stay. They are more interested in "status," using points to get room upgrades, a free breakfast, or anything that accords them conspicuous VIP treatment. Among other things, the preferred guest system allows staffers to see people's titles immediately. That makes it easier to give better rooms to managers than the subordinates they are traveling with and to greet them first when a party arrives.

After a long period in which Starwood paid more attention to its hipper W and Westin brands, the company has recently been remodeling its U.S. Sheratons. Among mainland Chinese travelers, the Sheraton name has continued to exude an aura of international class. While that is helpful for Sheraton's domestic Chinese business, the real potential will only be realized when they start to travel. The company's goal is to lock in the loyalty of mainland customers so they will stay at a Sheraton when they travel abroad. Indeed, if the experience with Japanese tourists in the mid-1980s is any guide, Starwood could be looking at 100 million or more outbound trips from China.

Global message strategies use the same message worldwide but allow for local adaptation of the offer. McDonald's, for example, is positioned virtually identical worldwide, but it serves vegetarian food in India and wine in France. The primary motivation behind this type of strategy is the enormous power behind a global brand. In industries in which customers increasingly develop similar expectations, aspirations, and values; in which customers are highly mobile; and in which the cost of product or service adaptation is fairly low, leveraging the global brand potential represented by one message worldwide often outweighs the possible disadvantages associated with factors such as higher local research and development (R&D) costs. As with global-offer strategies, however, global message strategies can be risky in the long run—global customers might not find elsewhere what they expect and regularly experience at home. This could lead to confusion or even alienation.

Mini Case: KFC abroad

KFC is synonymous with chicken. It has to be because chicken is its flagship product. One of the more recent offers the company created—all around the world—is the marinated hot and crispy chicken that is "crrrrisp and crunchy on the outside, and soft and juicy on the inside." In India, KFC offers a regular Pepsi with this at just 39 rupees. But

KFC also made sure not to alienate the vegetarian community—in Bangalore, you can be vegetarian and yet eat at KFC. Why? Thirty-five percent of the Indian population is vegetarian, and in metros such as Delhi and Mumbai, the number is almost 50%. Therefore, KFC offers a wide range of vegetarian products, such as the tangy, lip-smacking Paneer Tikka Wrap ‘n Roll, Veg De-Lite Burger, Veg Crispy Burger. There are munchies such as the crisp golden veg fingers and crunchy golden fries served with tangy sauces. You can combine the veg fingers with steaming, peppery rice and a spice curry. The mayonnaise and sauces do not have egg in them.

While the vegetarian menu is unique to India because of the country’s distinct tastes, KFC’s “standard” chicken products are also adapted to suit local tastes. For example, chicken strips are served with a local sauce, or the sauce of the wrap is changed to local tastes. Thus, KFC tries to balance aggregation with adaptation: standardization of those parts of the value offering that travel easily (KFC’s core products and positioning), tailoring of standard chicken products with a different topping or sauce, and offering a vegetarian menu.

This adaptation strategy is used in every country that KFC serves: the U.S. and European markets have a traditional KFC menu based on chicken burgers and wraps, while Asian offerings like those in India are more experimental and adventurous and include rice meals, wraps, and culture-appropriate sides.

Global change strategies define a “best fit” approach and are by far the most common. As we have seen, for most products, some form of adaptation of both the offer and the message is necessary. Differences in a product’s usage patterns, benefits sought, brand image, competitive structures, distribution channels, and governmental and other regulations all dictate some form of local adaptation. Corporate factors also play a role. Companies that have achieved a global reach through acquisition, for example, often prefer to leverage local brand names, distribution systems, and suppliers rather than embark on a risky global one-size-fits-all approach. As the markets they serve and the company become more global, selective standardization of the message and the offer itself can become more attractive.

Mini Case: targeting Muslim customers, power (2009, June 1)

Muslims often experience culture shock while staying in Western hotels. Minibars, travelers in bikinis, and loud music, among other things, embarrass Muslim travelers.

That is no longer necessary. A growing number of hotels has started to cater to Muslim travelers. In one, the lobby—decorated in white leather, brick, and glass, with a small waterfall—is quiet. Men in dishdashas and veiled women mingle with Westerners who are sometimes discreetly reminded to respect local customs. Minibars are stocked not with alcohol but with Red Bull, Pepsi, and the malt drink Barbican.

“Buying Muslim” used to mean avoiding pork and alcohol and getting your meat from a halal butcher, who slaughtered in accordance with Islamic principles. But the halal food market has exploded in the past decade and is now worth an estimated $632 billion annually, according to the Halal Journal, a Kuala Lumpur–based magazine. That amounts to about 16% of the entire global food industry. Throw in the fast-growing Islam-friendly finance sector and the myriad of other products and services—cosmetics, real estate, hotels, fashion, insurance, for example—that comply with Islamic law and the teachings of the Koran, and the sector is worth well over $1 trillion a year.

Seeking to tap that huge market, multinationals like Tesco, McDonald’s, and Nestlé have expanded their Muslim-friendly offerings and now control an estimated 90% of the global halal market.

Governments in Asia and the Middle East are pouring millions into efforts to become regional “halal hubs,” providing tailor-made manufacturing centers and “halal logistics”—systems to maintain product purity during shipping and storage. The intense competition has created some interesting partnerships in unusual places. Most of Saudi Arabia’s chicken is raised in Brazil, which means Brazilian suppliers had to build elaborate halal slaughtering facilities. Abattoirs in New Zealand, the world’s biggest exporter of halal lamb, have hosted delegations from Iran and Malaysia. And the Netherlands, keen to exploit Rotterdam’s role as Europe’s biggest port, has built halal warehouses so that imported halal goods are not stored next to pork or alcohol.

It is not just about food. Major drug companies now sell halal vitamins free of the gelatins and other animal derivatives that some Islamic scholars say make mainstream products haram, or unlawful. The Malaysia-based company Granulab produces synthetic bone-graft material to avoid using animal bone, while Malaysian and Cuban scientists are collaborating on a halal meningitis vaccine. For Muslim women concerned about skin-care products containing alcohol or lipsticks that use animal fats, a few cosmetics firms are creating halal makeup lines.

The growing Islamic finance industry is trying to win non-Muslim customers. Investors are attracted by Islamic banking’s more conservative approach: Islamic law forbids banks from charging interest (though customers pay fees), and many scholars discourage investment in excessively leveraged companies. Though it currently accounts for just 1% of the global market, the Islamic finance industry’s value is growing at around 15% a year, and it could reach $4 trillion in 5 years, according to a 2008 report from Moody’s Investors Service.

The previous section is taken from *Core Principles of International Marketing* from the Washington State. University’s open texts, PB PRESSBOOKS.

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Chapter 7

Global Branding

Learning objectives:

- Compare and contrast the three brand structures used in international marketing: corporate-dominant, product-dominant, and hybrid

- Analyze a given article based on the international brand strategy used

- Assess the worth of well-known companies using brand value criterion

As companies expand globally, a brand like Coke or Nike can be the greatest asset a firm has, but it also can quickly lose its power if it comes to signify something different in every market. Allowance must be made for flexibility in execution because even the smallest differences in different markets' consumer preferences, habits, or underlying cultures can make or break a brand's global success. In allowing such flexibility, a key consideration is how a product's current positioning in a particular market might affect the company's future offerings. If a product's positioning varies significantly in different markets, any "follow-on products" will likely have to be positioned differently as well, and this raises costs and can create operational problems.

Global branding vs. global positioning

Johnson & Johnson (J&J) will not sacrifice premium pricing for its well-known brands. It believes that its popular Band-Aid adhesive bandages are superior to competitors' products, and a premium price is a way to signal that. However, even in this dimension of its marketing strategy, J&J must allow for some improvisation as it expands around the world and pushes deeper into less-developed countries. Specifically, the company accepts lower margins in a developing market and sometimes delivers a smaller quantity of a product to make it more affordable. For instance, it might sell a four-pack of Band-Aids instead of the larger box it markets in the developed world or a sample-sized bottle of baby shampoo instead of a full-sized one.

Carefully adhering to a particular positioning creates uniformity in different world markets, but it also serves to define target segments as the company enters new countries or regions. Consider the decision by Diageo, the British beer-and-spirits company, to stick to premium pricing wherever it does business, even when it enters a new market. By projecting a premium positioning for brands such as Johnnie Walker Black, Smirnoff vodka, Captain Morgan rum, Tanqueray gin, and Guinness stout, and foregoing price cutting to grow volume, it identifies loyal consumers who will pay for its well-known products. Rather than sell its products' functional benefits, Diageo successfully markets its drinks as either sophisticated, as it does with Tanqueray, or cool, as it does with Captain Morgan in its recent "Got a Little Captain in You?" ad campaign. Brand managers' high-wire act (2007, October 31).

Minicase: global positioning of MasterCard

Back in 1997, the MasterCard "brand" did not stand for any one thing. The parent company—MasterCard International—had run through five different advertising campaigns in 10 years and was losing market share at home and abroad. Fixing the brand was a key element of the turnaround. Working with McCann-Erikson, the company developed the highly successful "priceless" campaign. The positioning created by "priceless" allowed MasterCard to integrate all its other campaigns and marketing practices within the United States, and this became a marketing platform that formed the basis for many globalization decisions.

Up until that time, every country used a different agency, a different campaign, and a different strategy. The success of "priceless" as a platform in the United States helped the company persuade other countries to adopt one, single approach, which, over time, produced a consistent global positioning. The "priceless" campaign now appears in more than 100 countries and more than 50 languages and informs all brand communications.

Starting with a locally developed positioning and then successfully expanding it globally is one way to approach the global branding and positioning challenge. More typically, companies start by identifying a unique consumer insight that is globally applicable in order to create a global positioning platform. No matter which route is selected, successful global branding and positioning requires (a) identifying a globally "robust" positioning platform—MasterCard's new positioning was readily accepted across all markets because of the quality of the insight and its instant recognition across cultural boundaries—and (b) clarity about roles and responsibilities for decision making locally and globally. There was a shared understanding of how the primary customer insight should be used at every stage in the process and which aspects of the branding platform were nonnegotiable; expectations for performance were clearly defined and communicated on a global basis; and a strategic partnership with a single advertising agency allowed for consistent, seamless execution around the world.

By providing a single, unifying consumer insight that "defines" the brand's positioning, MasterCard has created economies of scale and scope and, hence, benefited from aggregation principles. The company uses adaptation and arbitrage strategies in its approach to implementation. It empowers local teams by inviting them to create content for their own markets within a proven, globally robust positioning framework. Additional, ongoing research generates insights that allow local marketers to create a campaign that they truly feel has local resonance while at the same time maintaining the core brand positioning.

Global brand structures

Multinational companies typically operate with one of three brand structures: (a) a corporate-dominant, (b) a product-dominant, or (c) a hybrid structure. A corporate-dominant brand structure is most common among firms with relatively limited product or market diversity, such as Shell, Toyota, or Nike. Product-dominant structures, in contrast, are often used by (mostly industrial) companies, such as Akzo Nobel, that have multiple national or local brands or by firms such as Procter & Gamble (P&G) that have expanded internationally by leveraging their “power” brands. The most commonly used structure is a hybrid (think of Toyota Corolla cars or Cadbury Dairy Milk chocolate) consisting of a mix of global (corporate), regional, and national product-level brands or different structures for different product divisions.

In many companies, “global” branding evolves as the company enters new countries or expands product offerings within an existing country. Typically, expansion decisions are made incrementally, and often on a country-by-country, product-division, or product-line basis, without considering their implications on the overall balance or coherence of the global brand portfolio. As their global market presence evolves and becomes more closely interlinked, however, companies must pay closer attention to the coherence of their branding decisions across national markets and formulate an effective global brand strategy that transcends national boundaries. In addition, they must decide how to manage brands that span different geographic markets and product lines, who should have custody of international brands and who is responsible for coordinating their positioning in different national or regional markets, as well as making decisions about use of a given brand name on other products or services.

To make such decisions, companies must formulate a coherent set of principles to guide the effective use of brands in the global marketplace. These principles must define the company’s “brand architecture,” that is, provide a guide for deciding which brands should be emphasized at what levels in the organization, how brands are used and extended across product lines and countries, and the extent of brand coordination across national boundaries.

Minicase: Henkel’s “Fox” Brands’ example of a hybrid strategy

Like many European companies, Henkel, the German consumer-brands corporation, has globalized mostly via acquisitions, and, consequently, it has a portfolio of localized brands with a national heritage and good local market shares. As the portfolio grew, escalating media costs, increased communication and stronger linkages across markets, and the globalization of distribution created pressures for parsimony in the number of the firm’s brands and the consolidation of architecture across countries and markets. Henkel executives understood very well that a focus on a limited number of global strategic brands can yield cost economies and potential synergies. At the same time, they also knew that they needed to develop procedures for managing the custody of these brands, and that these should be clearly understood and shared throughout all levels of the organization, thus promoting a culture focused on global growth. They knew that failing to do so would likely trigger territorial power struggles between corporate and local teams for control of the marketing agenda.

While many companies would have focused on deciding between sacrificing local brand equity to develop “global power brands” (aggregation) or continuing to sacrifice global marketing economies of scale by investing separately in its portfolio of local brands (adaptation), Henkel chose an ingenious middle path. Henkel’s choice serves as a model for globalization of marketing concepts without loss of local brand equity through the grouping of all its “value-for-money” brands under the umbrella “Fox” brand. In each country, Henkel retained the local brand name but identifies it with the Fox umbrella brand. (In most cultures, the fox is seen as clever, selfish, and cunning—the sort of character who would buy a value-for-money brand but not a brand so cheap that its quality might be compromised.)

By using a fox to represent smart and cunning shoppers, Henkel has created a “global power brand concept” that can travel to almost any culture to enrich a local brand—especially local brands that individually could not have been globalized. But the scale economies Henkel gains from this program are more managerial than economic in nature. Programs and ideas to promote the Fox brands, and the concept of value-for-money detergents, are managed centrally and offered as a menu to all local markets in which these brands participate. Thus, a manager experienced in managing one of the Fox families of brands in one market can be transferred to another market and rapidly reach effective levels of performance. Because each brand still requires local investment, financial economies of scale are more modest.

Compare Henkel’s success to the failures of its major competitors as they tried to fully globalize their brand portfolios. Years ago, P&G, for example, attempted to globalize its European laundry detergent operations. In 2000, the company renamed its popular “Fairy” laundry detergent in Germany “Dawn” to position the latter as a global brand. There was no change in the product’s formulation. But by the end of 2001, P&G’s market share of Dawn in Germany had fallen drastically. While Fairy had represented a familiar and trusted brand persona to German consumers, Dawn meant nothing. With the renaming, the bond between consumers and the brand was broken; not even changing the brand’s name back to Fairy could restore it.

This experience suggests that attempting to achieve global brand positioning by deleting local brands can be problematic. In fact, a strategy of acquisition, and the subsequent shedding, of local brands by multinationals may actually create fragmentation in consumer demand rather than be a globalizing force. Such a scenario is particularly plausible if one or more of the local brands have reached “icon” status. Icon brands do not necessarily have distinctive features, deliver good service, or represent innovative technology. Rather, they resonate deeply with consumers because they possess cultural brand equity. Most of these brands fall into lifestyle categories: food, apparel, alcohol, and automobiles.

Determinants of global brand structure

The kinds of issues a company must resolve as it tries to shape a coherent global branding strategy reflect its globalization history—how it has expanded internationally and how it has organized its international operations. At any given point, the structure of a brand portfolio reflects a company’s past management decisions as well as the competitive realities the brand faces in the marketplace. Some companies, such as P&G and Coca-Cola, expanded primarily by taking domestic “power” brands to international markets. As they seek to expand further, they must decide whether to further extend their power brands or to develop brands geared to specific regional or national preferences and how to integrate the latter into their overall brand strategy. Others, such as Nestlé and Unilever, grew primarily by acquisition. As a consequence, they relied mainly on country-centered strategies, building or acquiring a mix of national and international brands. Such companies must decide how far to move toward greater harmonization of brands across countries and how to do so. This issue is particularly relevant in markets outside the United States, which often are fragmented, have small-scale distribution, and lack the potential or size to warrant the use of heavy mass-media advertising needed to develop strong brands.

Specifically, a company’s international brand structure is shaped by three sets of factors: (a) firm-based characteristics, (b) product-market characteristics, and (c) underlying market dynamics. Douglas, Craig, and Nijssen (2001).

Firm-based characteristics

Firm-based characteristics reflect the full array of past management decisions. First, a company’s administrative heritage—in particular, its organizational structure—defines the template for its brand structure.

Second, a firm's international expansion strategy—acquisition or organic growth—affects how its brand structure evolves over time. What is more, the use of strategic alliances to broaden the geographic scope of the firm's operations often results in a "melding" of the brand strategies of the partners. Third and fourth, the importance of corporate identity and the diversity of the firm's product lines and product divisions also determine the range and number of brands.

An appreciation of a company's administrative heritage is critical to understanding its global brand structure. Bartlett and Ghoshal (1989). A firm that has historically operated on a highly decentralized basis, in which country managers have substantial autonomy and control over strategy as well as day-to-day operations, is likely to have a substantial number of local brands. In some cases, the same product may be sold under different brand names in different countries. In others, a product may be sold under the same brand name but have a different positioning or formulation in different countries.

Firms with a centralized organizational structure and global product divisions, such as Panasonic or Siemens, are more likely to have global brands. Both adopted a corporate branding strategy that emphasizes quality and reliability. Product lines are typically standardized worldwide, with minor variations in styling and features for local country markets.

Firms that expand internationally by acquiring local companies, even when the primary goal is to gain access to distribution channels, often acquire local brands. If these brands have high local recognition or a strong customer or distributor franchise, the company will normally retain the brand. This is particularly likely if the brand does not occupy a similar positioning to that of another brand currently owned by the firm. Nestlé and Unilever are examples of companies following this type of expansion strategy.

Expansion is often accompanied by diversification. Between 1960 and 1990, Nestlé expanded by acquiring a number of companies in a range of different product-markets, mostly in the food and beverage segment. These acquisitions included well-known global brands such as Perrier and San Pellegrino (mineral water), confectionery companies such as Rowntree and Perugina, pet food companies and brands such as Spillers and Alpo, and grocery companies such as Buitoni, Crosse & Blackwell, and Herta. The resulting proliferation of brands created the need to consolidate and integrate company-branding structures. Douglas, Craig, and Nijssen (2001), p. 101.

Firms that have expanded predominantly by extending strong domestic, so-called power brands into international markets primarily use product-level brand strategies. P&G, for instance, has rolled out several of its personal products brands, such as Camay and Pampers, into international markets. This strategy appears most effective when customer interests and desired product attributes are similar worldwide and brand image is an important cue for the consumer.

The relative importance placed by the firm on its corporate identity also influences brand structure. Companies such as General Electric (GE) and Apple place considerable emphasis on corporate identity in the communications strategies. In the case of GE, "Imagination at Work" is associated with a corporate reputation dedicated to turning innovative ideas into leading products and services that help alleviate some of the world's toughest problems. Equally, Apple uses its apple logo to project the image of a vibrant innovator in the personal computer market. Increasingly, companies use their corporate identity as a means of reassuring customers and distributors that the company is reliable and stands behind its products. As a result, even companies with highly diverse product lines—such as Samsung—rely on the corporate brand name (and its logo) to project an image of reliability.

A fourth determinant of a company's brand structure is the diversity, or, conversely, the interrelatedness of the product businesses in which the firm is involved. Firms that are involved in closely related product lines or businesses that share a common technology or rely on similar core competencies often emphasize corporate brands. 3M Corporation, for example, is involved in a wide array of product businesses worldwide, ranging from displays and optics to health care products to cleaners to abrasives and adhesives. All rely heavily on engineering skills and have a reputation of being cutting-edge. The use of the 3M brand provides reassurance and reinforces the firm's reputation for competency and reliable products worldwide.

Minicase: pharmaceutical companies try global branding

In Paris, stomach ulcers are treated with Mopral; in Chicago, it is called Prilosec. These two products are, in fact, exactly the same drug. Prilosec is the U.S. brand of AstraZeneca's omeprazole; Mopral is its French counterpart. Unlike manufacturers of consumer goods, the pharmaceutical industry traditionally has been wary of creating big, international brands. But that is about to change. Take a look at pharmacists' shelves. Viagra is there. So are Celebrex for arthritis pain, the antidiabetic agent Avandia, and the anticoagulant Plavix.

It is perhaps surprising that companies did not consider global branding sooner because a drug works for everybody in the same way in every country. While the industry has become global from a technological and geopolitical perspective, few companies have mastered globally integrated marketing practices. But change is coming—and fast. As more people travel internationally and the Internet makes information—including drug advice—readily available for doctors and patients, companies want to avoid any brand inconsistencies while maximizing exposure. Another globalizing force is growing standardization of the regulatory environment. With the establishment of the European Medical Evaluations Agency, for example, which approves drugs for all the members of the European Union, the borders are coming down. Japan has also adapted its approval system to facilitate the entry of Western products.

And then there is direct-to-consumer (DTC) advertising. While doctors and health care professionals remained the targets for pharmaceutical marketing, consumer-style branding was unnecessary. But companies are preparing for the spread of DTC beyond the shores of the United States. The introduction of global branding anticipates the transition to a more consumer-driven market.

Pressure to cut or contain costs is perhaps the most powerful driver behind the industry's move to global branding. Mega mergers were a way to contain the costs of research and development and find pipeline products, yet the big companies still need about five new blockbuster products each year to return the promised growth. Global branding promises reduced marketing costs and much faster and higher product rollout.

Local market conditions, such as reimbursement policies, however, may still override the benefits of global strategies and therefore inhibit the globalization of brands. Local flexibility will be key to success. Significant cost savings may therefore be slow in coming. Even with a centralized, global brand, most companies will still likely use local agencies for their marketing campaigns.

Product-market factors

Three product-market factors play an important role in brand architecture: the nature and scope of the target market, the product's cultural associations, and the competitive market structure. Douglas, Craig, and Nijssen (2001), p. 103.

When companies target a global market segment with relatively homogeneous needs and preferences worldwide, global brands provide an effective means of establishing a distinctive global identity. Luxury brands such as Godiva, Moet and Chandon, and Louis Vuitton, as well as brands such as deBeers, Benetton, and L'Oreal are all targeted to the same market segment worldwide and benefit from the cachet provided by their appeal to a global consumer group. Sometimes it is more effective to segment international markets by region and target regional segments with similar interests and purchase behavior, such as Euro-consumers. This provides cost efficiencies when such segments are readily accessible through targeted regional media and distribution channels.

A critical factor influencing brand structure is the extent to which the product is associated with a particular culture, that is, the extent to which there are strong and deeply ingrained local preferences for specific products or product variants (think of beer) or the products are an integral part of a culture (think of bratwurst, soccer teams). The stronger the cultural association, the less likely it is that global product brands will thrive; instead, local branding may be called for.

A third product-market driver of a company's brand structure is the product's competitive market structure, defined as the relative strength of local (national) versus global competitors in a given product market. If markets are fully integrated and the same competitors compete in these markets worldwide, as in aerospace, the use of global brands helps provide competitive differentiation on a global basis. If strong local, national, or regional competitors, as well as global competitors, are present in a given national or regional market, the use of a multi-tier branding structure, including global corporate or product brands as well as local brands, is desirable. Coca-Cola, for example, beyond promoting its power brands, has introduced several local and regional brands that cater to specific market tastes around the world.

Minicase: use of country of origin effects in global branding

Whether you prefer obscure imports or something mainstream, most beer brands like to invoke their country of origin. Guinness comes from Ireland, Corona is Mexican, Heineken and Amstel are Dutch, and Budweiser is a truly American brand.

The use of "country of origin effects" is an essential part of beer branding. Using the country of origin as part of the brand equity is free, so companies can avoid having to build an image from scratch over decades. For a long time, Foster's used a kangaroo in its advertisements, while Lapin Kulta, from Lapland in Finland, relies heavily on its unusual provenance in its marketing. Images of Finland's stark landscapes adorn communications material and bottle labels.

Swiss watchmakers certainly know the value of their "Swiss made" brand. The Federation of the Swiss Watch Industry actively polices all uses of the term and has strict guidelines on how it may be used on clocks and watches. In a similar vein, the French leverage their reputation for good wine, cooking, and fashion and the Italians view themselves as the masters of style.

German companies have been particularly effective in leveraging country effects. Of Interbrand's Top 100 Global Brands in 2008, 10 were German brands—five automobile brands (BMW, Porche, Mercedes-Benz, Volkswagen, and Audi), while brands in technology (SAP and Siemens), clothing (Adidas), financial services (Allianz), and cosmetics (Nivea) were also represented. Together, this group of German brands is valued at over $98 billion. Germany was second only to the United States in the number of brands making the Top 100 list.

It should come as no surprise, then, that Germany itself was ranked the best overall "country brand" in the 2008 Anholt-GfK Roper Nation Brands Index, which measures the world's perception of each nation as if it were a public brand. Fifty nations were measured in the study.

The United States, the world's leading branding powerhouse, ranked seventh. So what is it about German brands, and the country that produces them, that is so special? Two words might be all the explanation that's required: discipline and quality.

German companies are highly disciplined in their approach to creating, introducing, and selling brands. They have the ability to consistently produce exceptional-quality products that are of lasting value. "German engineering" is a term closely associated with the country's automobile industry, which has seen a level of global success second only to the Japanese automakers. In fact, between 1990 and 2000, Mercedes-Benz and BMW more than doubled their sales in the United States alone.

Why do customers like German brands? German companies are widely admired for their intense focus on product quality and service, thought to be less interested in competing on price and strict about adhering to safety and other government standards.

BMW, a maker of premium automobiles, is one such revered brand. Founded in 1917 in Munich, Germany, as "Bavarian Motor Works," BMW produced aircraft engines during World War I, then built motorcycles in 1923 and went on to make cars in 1928. In recent years, BMW has been recognized as much for its innovative, quality marketing as for its high-performance cars.

But Germany's branding power extends well beyond automobiles. NIVEA, whose name comes from the Latin for "snow white," was created in late 1911. From its origins as a simple cream, NIVEA has now grown into a global manufacturer of a broad range of cosmetic and personal care products. NIVEA was voted the most trusted skin-care brand in 15 countries in the Reader's Digest survey of European Trusted Brands 2007.

Adidas, named after its founder Adolf (Adi) Dassler (Das), is an 80-year-old company that today is a global leader in sports footwear, apparel, and accessories. In 1996, Adidas equipped 6,000 Olympic athletes from 33 countries with its athletic gear. "Adidas athletes" won 220 medals, including 70 gold, and apparel sales increased 50%.

SAP, founded in 1972, is the world's largest business software company and the third-largest software supplier overall. The company employs almost 52,000 people and serves more than 76,000 customers in over 120 countries.

Other well-known global brands, from Bayer (pharmaceuticals) to Becks (beer) to Boss (clothing) to Braun (consumer products), are a testament to the fact that Germany is, and will continue to be, a prolific producer of some of the world's finest products. It is Germany's disciplined approach to quality that inspires consumer loyalty to German brands.

Market dynamics

Finally, while the firm's history and the product markets in which it operates shape its brand structure, market dynamics—including ongoing political and economic integration, the emergence of a global market infrastructure, and consumer mobility—shape and continually change the context in which this evolves.Douglas, Craig, and Nijssen (2001), p. 104.

Increasing political and economic integration in many parts of the world has been a key factor behind the growth of international branding. As governments remove tariff and nontariff barriers to business transactions and trade with other countries, and as people and information move easily across borders, the business climate has become more favorable to the marketing of international brands. Firms are less frequently required to modify products to meet local requirements or to develop specific variants for local markets and increasingly can market standardized products with the same brand name in multiple country markets. In many cases, harmonization of product regulation across borders has further facilitated this trend.

The growth of a global market infrastructure is also a major catalyst to the spread of international brands. Global and regional media provide economical and effective vehicles for advertising international brands. At the same time, global media help lay the groundwork for consumer acceptance of, and interest in, international brands by developing awareness of these brands and the lifestyles with which they are associated in other countries. In many cases, this stimulates a desire for the brands that consumers perceive as symbolic of a coveted lifestyle.

The globalization of retailing has further facilitated and stimulated the development of international manufacturer brands. As retailers move across borders, they provide an effective channel for international brands and, at the same time, increase their power. This forces manufacturers to develop strong brands with an international appeal so that they can negotiate their shelf position more effectively and ensure placement of new products.

A final factor shaping the context for international branding is increased consumer mobility. While global media provide passive exposure to brands, increasing international travel and movement of customers across national boundaries provides active exposure to brands in different countries. Awareness of the availability and high visibility of an international brand in multiple countries enhances its value to consumers and provides reassurance of its strength and reliability. Increased exposure to, and familiarity with, new and diverse products and the lifestyles and cultures in which they are embedded also generate greater receptivity to products of foreign origin or those perceived as international rather than domestic. All these factors help create a climate more favorable to international brands.

Formulating a global brand strategy

To create an effective global brand structure capable of spanning operations in different countries and product lines, companies must clearly define the importance and role of each level of branding (corporate, product division, or product brand level), as well as the interrelation or overlap of branding at each level. They should also determine the appropriate geographic scope for each level relative to the firm's current organizational structure. To be effective, such "architecture" should satisfy three key principles: parsimony, consistency, and connectivity.

Parsimony requires that the brand architecture should incorporate all existing brands, whether developed internally or acquired, and provide a framework for consolidation to reduce the number of brands and strengthen the role of individual brands. Brands that are acquired need to be melded into the existing structure, especially when these brands occupy similar market positions to those of existing brands. When the same or similar products are sold under different brand names or are positioned differently in each country, ways to harmonize these should be examined.

A second important element of brand architecture is its consistency relative to the number and diversity of products and product lines within the company. A balance needs to be struck between the extent to which brand names differentiate product lines or establish a common identity across different products. Development of strong and distinctive brand images for different product lines helps establish their separate identities. Conversely, use of a common brand name consolidates effort and can produce synergies.

The value of corporate brand endorsement across different products and product lines and at lower levels of the brand hierarchy—a brand's connectivity—also needs to be assessed. The use of corporate brand endorsement as either a name identifier or logo connects the different product brands to the company and helps provide reassurance to customers, distributors, and other value-chain partners. Implemented well, corporate brand endorsement can integrate and unify different brand identities across national boundaries. At the same time, corporate endorsement of a highly diverse range of product lines can result in dilution of image. Worse, if one product brand is "damaged," corporate endorsement can spread the resulting negative effects or associations to other brands in the portfolio and create lasting effects across multiple product lines. Thus, both aspects need to be weighed in determining the role of corporate brand endorsement in brand architecture.

Managing key strategic brands

Companies must also think about how to globally manage and monitor key strategic brands to ensure that they build and retain their integrity, visibility, and value. This entails assigning brand custody or appointing a brand champion responsible for approving brand extensions and monitoring brand positioning.

One option is to negotiate the harmonization of specific brand positions between corporate headquarters and country managers. This is appropriate for firms with strong country management that operate in product markets where brands were historically tailored to local market characteristics.

A more proactive and increasingly popular solution is to appoint a brand champion responsibility for building and managing a brand worldwide. This includes monitoring the consistency of the brand positioning in international markets as well as authorizing use of the brand (brand extensions) on other products or other product businesses. The brand champion can be a senior manager at corporate headquarters, a country manager, or a product development group. It is critical that the brand champion report directly to top management and have clear authority to sanction or refuse brand extensions to other product lines and product businesses so as to maintain the integrity of the brand and avoid brand dilution.

A third option is to centralize control of brands within a global product division. This approach is likely to be most effective when the business is targeted to a specific global market segment, with new products or brands, when there is greater consistency in market characteristics across countries, and when the company's administrative heritage has only a limited history of strong country management.

Benefits of corporate branding

Corporations around the world are increasingly becoming aware of the enhanced value that corporate branding strategies can provide (Holt, Quelch & Taylor, 2004). A strong corporate branding strategy can add significant value in terms of helping the entire corporation and the management team with implementing its long-term vision, creating unique positions in the marketplace for the company and its brands, and signaling a commitment to a broader set of stakeholder issues.

An effective corporate branding strategy therefore enables the company to leverage its tangible and non-tangible assets and promote excellence throughout the corporation. To be effective and meet such objectives, corporate branding requires a high level of personal attention and commitment from the CEO and the senior management.

Examples of effective corporate brands include Microsoft, Intel, Singapore Airlines, Disney, CNN, Samsung, and Mercedes. In recent years, the global financial powerhouses HSBC and Citibank have both acquired a vast number of companies across the globe and have fully adopted them under their international corporate brands with great success and within a relatively short time frame. All these companies understand that a well-executed corporate branding strategy can confer significant benefits.

Corporate brand as the "face of the company"

A strong corporate brand acts as the face of the company, portraying what it wants to do and what it wants to be known for in the marketplace. In other words, the corporate brand is the umbrella for the corporation's activities and encapsulates its vision, values, personality, positioning, and image, among many other dimensions. Think of HSBC. It employs the same slogan—"The world's local bank"—around the world. This creative platform enables the corporation to portray itself as a bridge between cultures.

Simplicity

An effective corporate branding strategy creates simplicity by making the top of the brand portfolio the ultimate identifier of the corporation. P&G is widely known for its multibrand strategy. Yet, the corporate name P&G encapsulates all of its activities. Depending on the business strategy and the potential need for multiple brands, a corporate brand can assist management focus on the company's core vision and values. Once established, it facilitates revisiting the definition of other brands in the corporations' portfolio and the creation of new brand identities.

Cost savings

A corporate branding strategy is often more cost-efficient than a multibrand architecture. Specifically, corporate branding produces efficiencies in terms of marketing and advertising spending as the corporate brand replaces budgets for individual product marketing efforts. Even a combined corporate and product branding strategy can often enable management to reduce costs and exploit synergies from a new and more focused brand architecture. The Apple brand has established a very strong position of being a design-driven and innovative company offering many types of products and services. Their corporate brand encapsulates the body and soul of the company, and the main messages from the company use the corporate Apple brand. Various sub-brands then help to identify the individual product lines.

Corporate brands as assets

Interbrand

In recent years, corporate brands themselves have become valuable assets on the company balance sheet, with market values very often much beyond book value.

Interbrand, a leading international brand consultancy specializing in brand services and activities, has developed a method for valuing (global) brands. It examines brands through the lens of financial strength, the importance of the brand in driving consumer selection, and the likelihood of ongoing revenue generated by the brand.

Each year, Interbrand compiles a list of global brands for analysis based on five criteria:

1. There must be substantial publicly available financial data for the brand.
2. One-third of the brand's revenues must come from outside its country of origin.
3. The brand must be positioned to play a significant role in the consumers' purchase decision.
4. The Economic Value Added (EVA) must be positive, showing that there is revenue above the company's operating and financing costs.
5. The brand must have a broad public profile and awareness.

The use of these criteria excludes a number of brands one might expect to be included. The Mars and BBC brands, for example, are privately held and do not have financial data publicly available. Wal-Mart, although it does business in international markets, does not do so under the Wal-Mart brand and is therefore not sufficiently global. Certain industry sectors are also not included in Interbrand's study.

An example is provided by telecommunication brands, which tend to have strong national roots and have faced awareness challenges due to numerous mergers and acquisitions. The major pharmaceutical companies, while very valuable businesses, are also excluded since their consumers tend to build a relationship with the product brands rather than the corporate brand.

For brands that meet the Interbrand criteria, the company next looks at the current financial health of the business and brand, the brand's role in creating demand, and the future strength of the brand as an asset to the business.

Financial analysis

Interbrand's model first forecasts the current and future revenue specifically attributable to the branded products. It subtracts operating costs from this revenue to calculate branded operating profit. Next, a charge is applied to the branded profit that is based on the capital a business spends versus the money it makes. This yields an estimate of a business's economic earnings. All financial analysis is based on publicly available company information.

Role of brand analysis

Brand analysis involves a measurement of how a brand influences customer demand at the point of purchase. It is applied to the economic earnings in order to arrive at the revenue that the brand alone generates (branded earnings). Interbrand uses in-house market research to establish individual brand scores against industry benchmarks to define the role a brand plays within the category. For example, role of brand is traditionally much higher in the luxury category than in the energy and utilities sector. The brand, not the business, is the principal reason consumers choose these goods and services.

Brand strength score

As brands are assets, valuing them requires an assessment of their ability to secure future earnings on behalf of the businesses that own them. Brand strength is a measure of the brand's ability to secure demand, and therefore earnings, over time. Securing customer demand typically means achieving loyalty, advocacy, and favorable levels of customer trial, as well as maintaining a price premium. Interbrand's methodology generates a discount factor that adjusts the forecasted brand earnings for their riskiness based on the level of demand the brand is able to secure. Brand strength is calculated by assessing the brand's performance against a set of seven critical factors, including measures of relevance, leadership, market position, customer franchise, diversification, and brand support.

Brand value

A brand's value is a financial representation of a business's earnings due to the superior demand created for its products and services through the strength of its brand. Brand value is the absolute financial worth of the brand as it stands today. Accordingly, the brand's value can be compared to the total value of the business as it would be assessed on the stock exchange.

The previous section is taken from Saylor.org's *Fundamentals of Global Strategy*, Chapter 7: Global Branding.

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Chapter 8

Global Supply Chains

Learning objectives:

- Define a supply chain
- Explain the traditional as well as the new supply-chain model
- Outline the advantages of global sourcing.
- Know the pros and cons of sole-sourcing and multi-sourcing.
- Describe the distribution-management choices companies have when entering new international markets

Global supply chains

A supply chain refers to the flow of physical goods and associated information from the source to the consumer. Key supply-chain activities include production planning, purchasing, materials management, distribution, customer service, and sales forecasting. These processes are critical to the success manufacturers, wholesalers, or service providers alike.

Electronic commerce and the Internet have fundamentally changed the nature of supply chains and have redefined how consumers learn about, select, purchase, and use products and services. The result has been the emergence of new business-to-business supply chains that are consumer-focused rather than product-focused. They also provide customized products and services.

In the traditional supply-chain model, raw material suppliers define one end of the supply chain. They were connected to manufacturers and distributors, which, in turn, were connected to a retailer and the end customer. Although the customer is the source of the profits, they were only part of the equation in this "push" model. The order and promotion process, which involves customers, retailers, distributors, and manufacturers, occurred through time-consuming paperwork. By the time customers' needs were filtered through the agendas of all the members of the supply chain, the production cycle ended up serving suppliers every bit as much as customers.

Driven by e-commerce's capabilities to empower clients, most companies have moved from the traditional "push" business model, where manufacturers, suppliers, distributors, and marketers have most of the power, to a customer-driven "pull" model. This new business model is less product-centric and more directly focused on the individual consumer. As a result, the new model also indicates a shift in the balance of power from suppliers to customers.

Whereas in the old "push" model, many members of the supply chain remained relatively isolated from end users, the new "pull" model has each participant scrambling to establish direct electronic connections to the end customer. The result is that electronic supply-chain connectivity gives end customers the opportunity to become better informed through the ability to research and give direction to suppliers. The net result is that customers now have a direct voice in the functioning of the supply chain, and companies can better serve customer needs, carry less inventory, and send products to market more quickly.

Mini Case: Zara's Global Business, ModelCapell, Kamenev, and Saminather, N. (2006, September 4)

Inditex, the parent company of cheap, chic-fashion chain Zara, has transformed itself into Europe's leading apparel retailer over the past 10 years and has racked up impressive results in Asia and the United States. Since 2000, Inditex has more than quintupled its sales and profits as it has tripled the number of stores of its eight brands. (Zara is the biggest, accounting for two-thirds of total revenues.) More recently, Inditex increased its year-on-year net sales by 6% in the first nine months of its 2009 fiscal year to 7,759 million euros. Net income grew to 831 million euros. The retailer launched 266 new stores in the first nine months, bringing the group's total number of stores to 4,530 by the end of October 2009.

Key highlights for the period included openings in Asian markets, with 90 new establishments inaugurated by October 31, 2009. These store openings reflect the strategic importance of Asian markets for the group and underscore a year of robust growth in China, Japan, and South Korea. High points of store launches so far this year include flagship locations in Japan and Mainland China.

In Japan, Zara now has a total of 50 stores, including a second flagship location in Tokyo's Shibuya district, which is a must-see global fashion destination. Prior to this opening, Zara had already welcomed shoppers at another upscale store in Shibuya. Zara thus enhances its excellent retail presence in Tokyo's four key shopping areas: the two aforementioned flagship stores in Shibuya, two each in Ginza and Shinjuku, and one in Harajuku.

Meanwhile, in Beijing, the group celebrated the opening of a flagship location in one of the Chinese capital's busiest shopping hubs. The store, which opened its doors on the pedestrian Wangfujing Street, brings the group's number of stores in China to more than 60. The company's firm commitment to expansion in the Chinese fashion market is reflected in its decision to locate shops not only in Beijing and Shanghai but also in emerging cities such as Harbin, Dalian, Qingdao, Changchun, and Kunming.

To get where it is today, Zara has turned globalization on its head, distributing all of its merchandise, regardless of origin, from Spain. With more outlets in Asia and the United States, replenishing stores twice a week—as Zara does now—will become increasingly complex and expensive. The strain is already starting to show. Costs are climbing and growth in same-store sales is slowing: at outlets open for 2 years or more, revenues were up by 5% last year, compared with a 9% increase in 2004. So far, the company has managed to offset that problem by charging more for its goods as it gets farther from headquarters. For instance, Zara's prices in the United States are some 65% higher than in Spain, brokerage Lehman Brothers, Inc., estimates.

Zara has succeeded by breaking every rule in retailing. For most clothing stores, running out of best-selling items is a disaster, but Zara encourages occasional shortages to give its products an air of exclusivity. With new merchandise arriving at stores twice a week, the company trains its customers to shop and shop often. And forget about setting trends—Zara prefers to follow them. Its aim is to give customers plenty of variety at a price they can afford. Zara made 30,000 different items last year, about triple what the Gap did.

Zara does not collaborate with big-name designers and or use multimillion-dollar advertising campaigns. Instead, it uses its spacious, minimalist outlets—more Gucci than Target—and catwalk-inspired clothing to build its brand. Their advertising is their stores. To get shoppers' attention, Zara is located on some of the world's priciest streets: New York's Fifth Avenue, Tokyo's Ginza, Rome's Via Condotti, and the Champs-Elysees in Paris.

Keeping those locations flush with an ever-changing supply of new clothing means striking the right balance between flexibility and cost. So while rivals outsource to Asia, Zara makes its most fashionable items—half of all its merchandise—at a dozen company-owned factories in Spain. Clothes with a longer shelf life, such as basic T-shirts, are outsourced to low-cost suppliers, mainly in Asia and Turkey.

The tight control makes Zara more fleet-footed than its competitors. While rivals push their suppliers to churn out goods in bulk, Zara intentionally leaves extra capacity in the system. That results in fewer fashion mistakes, which means Zara sells more at full price, and when it discounts, it does not have to go as deep. The chain books 85% of the full ticket price for its merchandise, while the industry average is 60%.

Zara's nerve center is an 11,000-square-foot hall at its headquarters in Arteixo, a town of 25,000 in Galicia. That is where hundreds of twenty-something designers, buyers, and production planners work in tightly synchronized teams. It is there that the company does all of its design and distribution and half of its production. The concentrated activity enables it to move a dress, blouse, or coat from drawing board to shop floor in just 2 weeks, less than a quarter of the industry average.

Consider how Zara managed to latch onto one of hottest trends in just 4 weeks in 2006. The process started when trend-spotters spread the word back to headquarters: white eyelet—cotton with tiny holes in it—was set to become white-hot. A quick telephone survey of Zara store managers confirmed that the fabric could be a winner, so in-house designers got down to work. They zapped patterns electronically to Zara's factory across the street, and the fabric was cut. Local subcontractors stitched white-eyelet v-neck belted dresses and finished them in less than a week. The $129 dresses were inspected, tagged, and transported through a tunnel under the street to a distribution center. From there, they were quickly dispatched to Zara stores from New York to Tokyo, where they were flying off the racks just 2 days later.

Supply-chain management

Supply-chain management (SCM) has three principal components: (a) creating the supply-chain network structure, (b) developing supply-chain business processes, and (c) managing the supply-chain activities, Lambert and Cooper (2000, January).

The supply-chain network structure consists of the member firms and the links between these firms. Primary members of a supply chain include all autonomous companies or strategic business units that carry out value-adding activities in the business processes designed to produce a specific output for a particular customer or market. Supporting members are companies that simply provide resources, knowledge, utilities, or assets for the primary members of the supply chain. For example, supporting companies include those that lease trucks to a manufacturer, banks that lend money to a retailer, or companies that supply production equipment, print marketing brochures, or provide administrative assistance.

Supply chains have three structural dimensions: horizontal, vertical, and the horizontal position of the focal company within the end points of the supply chain. The first dimension, horizontal structure, refers to the number of tiers across the supply chain. The supply chain may be long, with numerous tiers, or short, with few tiers. As an example, the network structure for bulk cement is relatively short. Raw materials are taken from the ground, combined with other materials, moved a short distance, and used to construct buildings. The second dimension, vertical structure, refers to the number of suppliers or customers represented within each tier. A company can have a narrow vertical structure, with few companies at each tier level, or a wide vertical structure with many suppliers or customers at each tier level. The third structural dimension is the company's horizontal position within the supply chain. A company can be positioned at or near the initial source of supply, be at or near to the ultimate customer, or be somewhere between these end points of the supply chain.

Business processes are the activities that produce a specific output of value to the customer. The management function integrates the business processes across the supply chain. Traditionally, in many companies, upstream and downstream portions of the supply chain were not effectively integrated. Today, competitive advantage increasingly depends on integrating eight key supply-chain processes—customer relationship management, customer service management, demand management, order fulfillment, manufacturing flow management, procurement, product development and commercialization, and managing returns—into an effective value delivery network,

Regarding the supply-chain management function itself, in some companies, management emphasizes a functional structure, others a process structure, and yet others a combined structure of processes and functions. The number of business processes that it is critical or beneficial to integrate and manage between companies will likely vary. In some cases, it may be appropriate to link just one key process, and, in other cases, it may be appropriate to link multiple or all the key business processes. However, in each specific case, it is important that executives thoroughly analyze and discuss which key business processes to integrate and manage. With the shift from the traditional “push” to the modern “pull” model, supply-chain management has changed—the integration of e-commerce has produced (a) greater cost efficiency, (b) distribution flexibility, (c) better customer service, and (d) the ability to track and monitor shipments.

Supply-chain agility & resiliency

The best companies create supply chains that can respond to sudden and unexpected changes in markets. Agility—the ability to respond quickly and cost-effectively to unexpected change—is critical because in most industries, both demand and supply fluctuate more rapidly and widely than they used to. In fact, the best companies use agile supply chains to differentiate themselves from rivals. For instance, Zara has become Europe’s most profitable apparel brands by building agility into every link of their supply chains. At one end of the product pipeline, Zara has created an agile design process. As soon as designers spot possible trends, they create sketches and order fabrics. That gives them a head start over competitors because fabric suppliers require the longest lead times. However, the company approves designs and initiates manufacturing only after it gets feedback from its stores. This allows Zara to make products that meet consumer tastes and reduces the number of items they must sell at a discount. At the other end of supply chain, the company has created a superefficient distribution system. In part because of these decisions, Zara has grown at more than 20% annually since the late 1990s, and its double-digit net profit margins are the envy of the industry.

Agility and resiliency have become more critical in recent years because sudden shocks to supply chains have become more frequent. The terrorist attack in New York in 2001, the dockworkers’ strike in California in 2002, the SARS epidemic in Asia in 2003, and the Coronavirus in 2020 for instance, disrupted many companies’ supply chains.

Agility and resiliency help supply chains recover more quickly from such sudden setbacks. When, in September 1999, an earthquake hit Taiwan, shipments of computer components to the United States were delayed by weeks and, in some cases, by months. Most computer manufacturers, such as Compaq, Apple, and Gateway, could not deliver products to customers on time and incurred losses. One exception was Dell. The company changed the prices of PC configurations overnight to steer consumer demand away from hardware built with components that were not available to machines that did not require those parts. Dell could do this because it had contingency plans in place. Not surprisingly, Dell gained market share in the earthquake’s aftermath.

Supply-chain agility and resilience no longer imply merely the ability to manage risk. It now assumes that the ability to manage risk means being better positioned than competitors to deal with—and even gain advantage from—disruptions. Key to increasing agility and resilience is building flexibility into the supply-chain structure, processes, and management.

Global supply chains

Global companies must be able to adapt their supply networks when markets or strategies change. The best companies tailor their supply chains to the nature of the markets they serve. They often end up with more than one supply chain, which can be expensive, but, in return, they secure the best manufacturing and distribution capabilities for each offering. Cisco, for example, uses contract manufacturers in low-cost countries such as China for standard, high-volume networking products. For its broad line of midvalue items, the company uses vendors in low-cost countries to build core products, but it customizes those products itself in major markets such as the United States and Europe. And for highly customized, low-volume products, Cisco uses vendors close to main markets, such as Mexico for the United States and Eastern European countries for Europe. Despite the fact that it uses three different supply chains at the same time, the company is careful not to become less agile. Because it uses flexible designs and standardized processes, Cisco can switch the manufacture of products from one supply network to another, when necessary, Sheffi (2005, October).

Companies that compete primarily on the basis of operational excellence typically focus on creating supply chains that deliver goods and services to consumers as quickly and inexpensively as possible. They invest in state-of-the art technologies and employ metrics and reward systems aimed at boosting supply-chain performance.

For companies competing on the basis of customer intimacy or product leadership, a focus on efficiency is not enough—agility is a key factor. Customer-intimate companies must be able to add and delete products and services as customer needs change; product leadership companies must be able to adapt their supply chains to changes in technology and to capitalize on new ideas.

All companies must align their supply-chain infrastructure and management with their underlying value proposition to achieve a sustainable competitive advantage. That is, they must align the interests of all the firms in the supply network so that companies optimize the chain's performance when they maximize their interests.

Mini Case: Nikon, with the help of UPS, focuses on supply-chain innovation

To support the launch of its new digital cameras, Nikon, with the help of UPS Supply Chain Solutions, reengineered its distribution network to keep retailers well supplied. Nikon knew that customer service capabilities needed to be completely up to speed from the start and that distributors and retailers would require up-to-the-minute information about product availability. While the company had previously handled new product distribution in-house, this time Nikon realized that burdening its existing infrastructure with a new, demanding, high-profile product line could impact customer service performance adversely. So Nikon applied its well-known talent for innovation to creating an entirely new distribution strategy, and it took the rare step of outsourcing distribution of an entire consumer-electronics product line. With UPS Supply Chain Solutions on board, Nikon was able to quickly execute a synchronized supply-chain strategy that moves products to retail stores throughout the United States, Latin America, and the Caribbean, and allows Nikon to stay focused on the business of developing and marketing precision optics.

Starting at Nikon's manufacturing centers in Korea, Japan, and Indonesia, UPS Supply Chain Solutions now manages air and ocean freight and related customs brokerage. Nikon's freight is directed to Louisville, Kentucky, which not only serves as the all-points connection for UPS's global operations but is also home to the UPS Supply Chain Solutions Logistics Center main campus. Here, merchandise can be either "kitted" with accessories such as batteries and chargers or repackaged to in-store display specifications. Finally, the packages are distributed to literally thousands of retailers across the United States or shipped for export to Latin American or Caribbean retail outlets and distributors, using any of UPS's worldwide transportation services to provide the final delivery.

With the UPS Supply Chain Solutions system in place, the process calibrates the movement of goods and information by providing SKU-level visibility within complex distribution and information technology (IT) systems. UPS also provides Nikon advance shipment notifications throughout the U.S., Caribbean, and Latin American markets. The result: a "snap shot" of the supply chain that rivals the performance of a Nikon camera.

Nikon has already seen the results of its innovation in both digital technology and product distribution. The consumer digital-camera sector is one of Nikon's fastest-growing product lines. In addition, supply-chain performance and customer service have measurably improved. Products leaving Nikon manufacturing facilities in Asia can now be on a retailer's shelf in as few as 2 days. While products are en route, Nikon also has the ability to keep retailers informed of delivery times and to adjust them as needed so that no retailer needs to miss sales opportunities due to lack of product availability.

Leading companies take care to align the interests of all the firms in their supply chain with their own. This is important, because every supply-chain partner firm—whether a supplier, an assembler, a distributor, or a retailer—will focus on its own interests. If any company's interests differ from those of the other organizations in the supply chain, its actions will not maximize the chain's performance.

One way companies align their partners' interests with their own is by redefining the terms of their relationships so that firms share risks, costs, and rewards equitably. Another involves the use of intermediaries, for example, when financial institutions buy components from suppliers at hubs and resell them to manufacturers. Everyone benefits because the intermediaries' financing costs are lower than the vendors' costs. Although such an arrangement requires trust and commitment on the part of suppliers, financial intermediaries, and manufacturers, it is a powerful way to align the interests of companies in supply chains.

A prerequisite to creating alignment is the availability of information so that all the companies in a supply chain have equal access to forecasts, sales data, and plans. Next, partner roles and responsibilities must be carefully defined so that there is no scope for conflict. Finally, companies must align incentives so that when companies try to maximize returns, they also maximize the supply chain's performance.

Mini Case: Nestlé pieces together its global supply chain, Steinert-Threlkeld (2006, January)

A few years ago, Nestlé, the world's largest food company, set out to standardize how it operates around the world. It launched GLOBE (Global Business Excellence), a comprehensive program aimed at implementing a single set of procurement, distribution, and sales management systems. The logic behind the $2.4-billion project was impeccable: implementing a standardized approach to demand forecasting and purchasing would save millions and was critical to Nestlé's operating efficiency in 200 countries around the world.

Nestlé's goal was simple: to replace its 14 different SAP enterprise-planning systems—in place in different countries—with a common set of processes, in factory and in administration, backed by a single way of formatting and storing data and a single set of information systems for all of Nestlé's businesses.

For Nestlé, this was not an everyday project. When it built a factory to make coffee, infant formula, water, or noodles, it would spend $30 to $40 million; committing billions in up-front capital to a backroom initiative was unheard of, or, as someone noted, "Nestlé makes chocolate chips, not electronic ones."

The GLOBE project also stood as the largest-ever deployment of mySAP.com. But whether the software got rolled out to 230,000 Nestlé employees or 200 was not the point. The point was to make Nestlé the first company to operate in hundreds of countries in the same manner as if it operated in one. And that had not been achieved by any company—not even the British East India Company at the peak of its tea-trading power—in the history of global trade.

Consider the complexities. Nestlé was the world's largest food company, with almost $70 billion in annual sales. By comparison, the largest food company based in the United States, Kraft Foods, was less than half that size. Nestlé's biggest Europe-based competitor, Unilever, had about $54 billion in sales. In addition, Nestlé grew to its huge size by selling lots of small-ticket items—Kit Kat, now the world's largest-selling candy bar; Buitoni spaghetti; Maggi packet soups; Lactogen dried milk for infants; and Perrier sparkling water.

The company operated in some 200 nations, including places that were not yet members of the United Nations. It ran 511 factories and employed 247,000 executives, managers, staff, and production workers worldwide.

What is more, for Nestlé, nothing was simple. The closest product to a global brand it had was Nescafé; more than 100 billion cups were consumed each year. But there were more than 200 formulations, made to suit local tastes. All told, the company produced 127,000 different types and sizes of products. Keeping control of its thousands of supply chains, scores of methods of predicting demand, and its uncountable variety of ways of invoicing customers and collecting payments was becoming evermore difficult and eating into the company's bottom line.

The three baseline edicts for project GLOBE were: harmonize processes, standardize data, and standardize systems. This included how sales commitments were made, factory production schedules established, bills to customers created, management reports pulled together, and financial results reported. Gone would be local customs, except where legal requirements and exceptional circumstances mandated an alternative manner of, say, finding a way to pay the suppliers of perishable products like dairy or produce in a week rather than 30 days. And when was this all to be done? In just 3 and a half years. The original GLOBE timeline, announced by Nestlé's executive board, called for 70% of the company's $50 billion business to operate under the new unified processes by the end of 2003.

Mission impossible? The good news was that in one part of the world, Asia, market managers had shown they could work together and create a common system for doing business with their customers. They had used a set of applications from a Chicago supplier, SSA Global, that allowed manufacturers operating worldwide to manage the flow of goods into their factories, the factories themselves, and the delivery of goods to customers while making sure the operations met all local and regional legal reporting requirements. The system was adopted in Indonesia, Malaysia, the Philippines, Thailand, even South Africa, and was dubbed the "Business Excellence Common Application."

But this project was orders of magnitude more involved and more complex. Instead of just a few countries, it would affect 200 of them. Change would have to come in big, not small, steps. Using benchmarks they could glean from competitors such as Unilever and Danone, and assistance from PricewaterhouseCoopers consultants and SAP's own deployment experts, the executives in charge of the GLOBE project soon came to a conclusion they had largely expected going in: this project would take more people, more money, and more time than the board had anticipated. Instead of measuring workers in the hundreds, and Swiss francs in the hundreds of millions, as originally expected, the team projected that 3,500 people would be involved in GLOBE at its peak. The new cost estimate was 3 billion Swiss francs, about $2.4 billion. And the deadline was pushed back as well. The new target: putting the "majority of the company's key markets" onto the GLOBE system by the end of 2005, not 2003.

To lead this massive undertaking, GLOBE's project manager chose a group of business managers, not technology managers, from all of Nestlé's key functions—manufacturing, finance, marketing, and human resources—and from all across the world—Europe, Asia, the Americas, Africa, and Australia.

These were people who knew how things actually worked or should work. They knew how the company estimated the demand for each of its products, how supplies were kept in the pipeline, even mundane things like how to generate an invoice, the best way to process an order, how to maintain a copier or other office equipment, and how to classify all the various retail outlets, from stores to vending machines, that could take its candy bars and noodles. The system would allow managers to manage it all from the web.

The process for the team of 400 executives started with finding, and then documenting, the four or five best ways of doing a particular task, such as generating an invoice. Then, the GLOBE team brought in experts with specific abilities, such as controlling financial operations, and used them as “challengers.” They helped eliminate weaknesses, leaving the best practices standing.

At the end of that first year, the project teams had built up the basic catalog of practices that would become what they would consider the “greatest asset of GLOBE”: its “Best Practices Library.” This was an online repository of step-by-step guides to the 1,000 financial, manufacturing, and other processes that applied across all Nestlé businesses. Grouped into 45 “solution sets,” like demand planning or closing out financial reports, the practices could now be made available online throughout the company, updated as necessary, and commented on at any time.

It was not always possible to choose one best practice. Perhaps the hardest process to document was “generating demand.” With so many thousands of products, hundreds of countries, and local tastes to deal with, there were “many different ways of going to market,” many of which were quite valid. This made it hard to create a single software template that would serve all market managers.

So GLOBE executives had to practice a bit more tolerance on that score. The final GLOBE template included a half-dozen or so different ways of taking products to market around the world. But no such tolerance was shown for financial reporting. The 400 executives were determined to come up with a rigorous step-by-step process that would not change.

Experts were brought in along the way to challenge each process. But in the end, one standard would, in this case, have to stand. Financial terms would be consistent. The scheme for recording dates and amounts would be the same. The timing of inputting data would be uniform; only the output could change. In Thailand, there would have to be a deviation so that invoices could be printed out in Thai characters so that they could be legal and readable. In the Philippines, dates would have to follow months, as in the United States. Most of the rest of the world would follow the European practice of the day preceding the month.

Progress was slow, however. Nestlé managers had always conducted their businesses as they saw fit. As a consequence, even standardizing on behind-the-scenes practices, like how to record information for creating bills to customers met, with resistance. As country managers saw it, decision making was being taken out of local markets and being centralized. Beyond that, someone had to pay the bill for the project itself. That would be the countries, too.

By the fall of 2005, almost 25% of Nestlé was running on the GLOBE templates. And GLOBE’s project manager was confident that 80% of the company would operate on the new standardized processes by the end of 2006. The greatest challenge was getting managers and workers to understand that their jobs would change—in practical ways. In many instances, workers would be entering data on raw materials as they came into or through a factory. Keeping track of that would be a new responsibility. Doing it on a computer would be a wholly new experience. And figuring out what was happening on the screen could be a challenge. Minutia? Maybe. Considerable change? Definitely.

But the templates got installed and business went on—in Switzerland, Malaysia-Singapore, and the Andean region. In each successive rollout, the managers of a given market had 9 months or more to document their processes and methodically adjust them to the templated practices. In 2003, Thailand, Indonesia, and Poland went live. In 2004, Canada, the Philippines, and the Purina pet food business in the United Kingdom joined the network. But, by then, the system was bumping up against some technical limits. In particular, the mySAP system was not built for the unusual circumstances of the Canadian food retailing market. Food manufacturers have lots of local and regional grocery chains to sell to, and promotional campaigns are rife. MySAP was not built to track the huge amount of trade promotions engaged in by Nestlé's Canadian market managers: there were too many customers, too many products, and too many data points.

In India, changing over in mid-2005 was complicated by the fact that not only was Nestlé overhauling all of its business processes, but it also did not know what some of the key financial processes would have to be. At the same time it was converting to the GLOBE system, India was changing its tax structure in all 29 states and six territories. Each would get to choose whether, and how, to implement a fee on the production and sale of products, known as a value-added tax. Meeting the scheduled go-live date proved difficult.

And all over the world, managers learned that the smallest problem in standardized systems means that product can get stopped in its tracks. In Indochina, for instance, pallets get loaded with 48 cases of liquids or powders, and are then moved out. If a worker fails to manually check that the right cases have been loaded on a particular pallet, all dispatching stops are held up until the pallet is checked.

These setbacks notwithstanding, GLOBE taught Nestlé how to operate as a truly global company. For example, managers from the water businesses initially rejected the idea of collecting, managing, and disseminating data in the same way as their counterparts in chocolate and coffee. Some managers figured that if they were able to produce all the water or all the chocolate they needed for their market locally, that should be enough. But the idea was to get Nestlé's vast empire to think, order, and execute as one rather than as a collection of disparate companies. This meant that a particular manufacturing plant in a particular manager's region might be asked to produce double or triple the amount of coffee it had in the past. Or it might mean that a particular plant would be closed.

So, while the company did away with data centers for individual countries, each one does now have a data manager. The task is to make sure that the information that goes into GLOBE's data centers is accurate and complete. That means that country managers can concentrate more on what really matters: serving customers.

Global sourcing & distribution

Global sourcing refers to buying the raw materials or components that go into a company's products from around the world, not just from the headquarters' country. For example, Starbucks buys its coffee from locations like Colombia and Guatemala. The advantages of global sourcing are quality and lower cost. Global sourcing is possible to the extent that the world is flat—for example, buying the highest-quality cocoa beans for making chocolate or buying aluminum from Iceland, where it's cheaper because it's made using free geothermal energy.

When making global-sourcing decisions, firms face a choice of whether to sole-source (i.e., use one supplier exclusively) or to multisource (i.e., use multiple suppliers). The advantage of sole-sourcing is that the company will often get a lower price by giving all of its volume to one supplier. If the company gives the supplier a lot of business, the company may have more influence over the supplier for preferential treatment. For example, during a time of shortage or strained capacity, the supplier may give higher quantities to that company rather than to a competitor as a way of rewarding the company's loyalty.

On the other hand, using multiple suppliers gives a company more flexibility. For instance, if there's a natural disaster or other disruption at one of their suppliers, the company can turn to its other suppliers to meet its needs. For example, when Hurricane Mitch hit Honduras with 180-mile-per-hour winds, 70 to 80 percent of Honduras's infrastructure was damaged and 80 percent of its banana crop was lost. Both Dole Food Company and Chiquita bought bananas from Honduras, but Dole relied more heavily on bananas from Honduras than from other countries. As a result, Dole lost 25 percent of its global banana supply, but Chiquita lost only 15 percent.

Sole-Sourcing advantages

- Price discounts based on higher volume
- Rewards for loyalty during tough times
- Exclusivity brings differentiation
- Greater influence with a supplier

Sole-Sourcing disadvantages

- Higher risk of disruption
- Supplier has more negotiating power on price

Multisourcing advantages

- More flexibility in times of disruption
- Negotiating lower rates by pitting one supplier against another

Multisourcing disadvantages

- Quality across suppliers may be less uniform
- Less influence with each supplier
- Higher coordination and management costs

Whichever sourcing strategy a company chooses, it can reduce risk by visiting its suppliers regularly to ensure the quality of products and processes, the financial health of each supplier, and the supplier's adherence to laws, safety regulations, and ethics.

Ethics in action

The case of global sourcing

While there is little systematic research on questions related to ethics and global sourcing, one recent survey in the context of clothing manufacturers identified the following most encountered issues.

- **Child labor.** Forty-three percent of the respondents had encountered factories where child labor was being used. India, China, Thailand, and Bangladesh were cited as the worst offenders in this regard, partly because of the absence or unreliability of birth certificates, but also because of the difficulty that Westerners have in assessing the age of workers in these countries. Buyers relied on the management of the factory to check on documents supplied by the employee.

- **Dangerous working conditions and health and safety issues.** Forty-three percent of the respondents had encountered dangerous working conditions in factories. These included unsafe machinery (e.g., machine guards having been removed to speed up production), workers failing to use safety equipment such as cutting gloves, and the use and storage of hazardous chemicals (e.g., those used for dyeing and printing). Fire regulations were also sometimes inadequate, both in factories and in the dormitory accommodation often provided for workers who live away from their home regions.

Sometimes fire exits were locked, and fire extinguishers were missing.

- **Bribery and corruption.** Thirty-one percent of respondents said that they had experienced bribery and corruption. One blatantly fraudulent practice mentioned was for suppliers to mislead the buyer over the true source of production. Many suppliers claim that goods are made in one factory, then transfer the production elsewhere, making it difficult for the retailer to audit.
- **Exploitation of the workforce.** Twenty-five percent of respondents mention some aspect of exploitation of the workforce, encompassing the issues of child labor and health and safety. However, it can also cover low wages being paid to workers and excessive overtime being expected by employers. Respondents specifically mentioned that they had encountered worker exploitation. Many spoke of long working hours in factories, especially at peak periods, with employees often working over seventy hours per week.

Distribution management

Selling internationally means considering how your company will distribute its goods in the market. Developed countries have good infrastructure—passable roads that can accommodate trucks, retailers who display and sell products, and reliable communications infrastructure and media choices. Emerging markets, on the other hand, often have very fragmented distribution networks, limited logistics, and much smaller retailer outlets. Hole-in-the-wall shops, door-to-door peddlers, and street vendors play a much larger role in emerging-market countries. In the emerging countries of Africa, for example, books might be sold from the back of a moped.

In addition, the standards of living in emerging countries vary widely. Most of the middle class lives in cities, but the percentage of the population that lives in rural areas varies by country. In India, 70 percent of the population lives in rural areas, whereas in Latin America only 30 percent does.

Rural logistics are especially problematic. Narrow dirt roads, weight-limited bridges, and mud during the rainy season hamper the movement of goods. An executive at computer storage device manufacturer EMC noted that sometimes the company's refrigerator-sized, data-storage systems have had to be transported on horse-drawn wagons.

How Nokia tackles distribution challenges

Nokia is a $59 billion company with over 123,000 employees.3 It sells 150 different devices, of which 50 to 60 are newly introduced each year. Each device can be customized on many variants, including language and content. This variation adds greatly to the devices' complexity; three hundred to four hundred components need to arrive on time at factories in order for the devices to be built. Approximately one billion people use Nokia devices worldwide. Countries like China, India, and Nigeria, which ten years ago had almost zero penetration of mobile phones, now have twenty million to forty million users each. Emerging markets now account for over half of Nokia's annual sales.

Nokia has the challenge of selling a growing variety of mobile devices in hundreds of thousands of tiny retail outlets in the developing world. To tackle reaching its rural customers in developing countries, Nokia has 350,000 points of presence in rural areas, from small kiosks and corner shops to organized retail outlets. Nokia has 100,000 such point-of-sale (POS) outlets in India, 80,000 in China, and 120,000 in the Middle East and Africa.

Organizing the channel

Either through a planned process or through a natural evolution, channels of distribution reflect an observable organization structure.

Three types are most common: conventional channels, vertical marketing systems, and horizontal channel systems.

Conventional channels

The conventional channel of distribution could be described as a group of independent businesses, each motivated by profit, and having little concern about any other member of the distribution sequence. There are no all-inclusive goals, and in many instances, the assignment of tasks and the evaluation process are totally informal. Consequently, channel frameworks might be working against one another, tasks may go undone, and ineffective channel member relationships may last for years. Despite these deficiencies, this type of channel structure remains most common, and there are numerous examples of such networks working.

Vertical marketing systems

Vertical marketing systems have emerged as a solution to the problems of conventional networks. A vertical marketing system (VMS) comes about when a member of the distribution channel (usually the manufacturer) assumes a leadership role and attempts to coordinate the efforts of the channel so that mutually beneficial goals can be attained. Three forms of vertical integration are now common.

Administered VMS

The administered VMS is very close to the conventional network, but differs in that it is informally guided by goals and programs developed by one or a limited number of firms in the existing channel. This framework is the source of the concept of a channel captain, in that administrative skills and the power of one individual may be the driving force of the channel. Often the dominant brands, as in the case of Xerox or Procter & Gamble, are able to manifest this cooperation.

Through the recognition of a channel leader, the distribution networks function better, sales and profits are higher, product exposure improves, inventory management systems are initiated, and the coordination of promotional activities becomes a reality. An administered system is not without its problems. Often, this effort is placed on the shoulders of a single individual. Another drawback is the tendency of polarizing channel members. Businesses either become part of the VMS or remain strongly independent. Eventually these independents may find themselves at a tremendous competitive disadvantage, and may even be deprived of certain channel benefits.

Contractual VMS

There are instances when channel members wish to formalize their relationship by employing a contractual agreement, known as a contractual VMS. This provides additional control, and either explicitly or implicitly spells out the marketing functions to be performed by all the members of the channel. This is the most popular form of vertical marketing arrangement.

Corporate VMS

When channel members on different levels are owned and operated by one organization, a corporate vertical marketing system is said to exist. Such integration can be forward or backward. A manufacturer who owns the various intermediaries in its channel network has engaged in forward integration. A retailer who takes over the wholesaling and manufacturing tasks is backward integrating. This process can entail either the organization's purchasing the institutions, or establishing its own facilities. Although partial forward or backward integration is most common, total integration is becoming more popular. Manufacturers who have recently integrated through to the retail level are Dannon Yogurt, Blue Bell Ice Cream, and Pepperidge Farms. Sears and Safeway stores are two retailers that have successfully integrated backward. American Hospital Supply

Corporation is an example of a wholesaler that has integrated both backward and forward.

Horizontal channel systems

There are instances where two or more companies are unable to acquire the capital, or do not have the technical or production know-how, to effectively market their products alone. In such cases, these companies may establish a temporary or quasi-permanent relationship in order to work with each other, and create the channel mechanism required to reach their target markets. This arrangement has been labeled a horizontal channel system. For example, two small manufacturers might combine their shipments to common markets in order to gain full carload transportation rates that each could not obtain separately. Another common scenario is for a large retailer to buyout several competing small retailers in order to gain entry into certain markets or with certain customers.

Mini Case: Unilever solves distribution issues in India

Hindustan Unilever Limited (HUL), Unilever's Indian subsidiary, wanted to reach the 70 percent of Indians who live in rural villages. This underserved market is very hard to reach. Not only is marketing to remote villages difficult, but the physical transport of products is no easier. Most of the villages lack paved roads, making traditional truck-based distribution arduous. The only way to reach many of these remote villages is by single-track dirt trails.

In response to these conditions, HUL has created Project Shakti (the word means "strength") and developed a network of 14,000 women and women-owned cooperatives to serve 50,000 villages. The women handle the logistics and door-to-door retailing of a range of personal-care products. To address the needs of the market and this novel distribution system, HUL has packaged its products in much smaller sizes. The effort has created $250 million in new revenues for HUL, of which 10 percent is used for financing the women entrepreneurs. By using this approach, HUL doesn't have to deal with the problem of moving products in rural India. The women or their employees come to the company's urban distribution centers to get the products.

The previous section is taken from *Core Principles of International Marketing* from the Washington State. University's open texts, PB PRESSBOOKS.

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Appendices

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Appendix A

A case example: exporting to Brazil

A U.S. manufacturer based in Los Angeles is planning to export a product to Sao Paulo, Brazil. The product will be purchased by a Brazilian distributor who in turn will sell to a retail store. For this product:

Selling Price: $10,000

Payment: letter of credit

Terms of sale: Ex-works Los Angeles

Note: Ex Works is a shipping term meaning the buyer (in this case the Brazilian distributor) pays all freight from Los Angeles.

The company wants to work through the pricing calculation to determine if its product will be competitive. It is specifically concerned whether the $10,000 sell price is going to be low enough to compete with a product produced in Brazil and another that is imported from Argentina. This involves the following three steps:

1. Calculation of the landed price
2. Calculation of the price at which the distributor will sell to the retailer, and the price at which the retailer will sell to the public. This example assumes the distributor marks up the product by 33 percent and the retailer marks up the product by 40 percent.
3. Comparison of these prices to a locally produced product and one imported from Argentina. As Brazil and Argentina are members of Mercosur, there is no import duty on the Argentine product. The comparison assumes the Brazilian and Argentine products are sold through the same distribution channel with the same markups.

Step 1: Calculating the foreign market landed cost

The initial step in developing a local pricing model for a particular foreign market is to calculate the landed cost. Essentially the landed cost calculation attempts to identify all costs associated with getting the product from the U.S. manufacturing facility to the door of the foreign buyer including logistics and import duties. It would not typically include local taxes or local distribution costs because these would affect domestic products as well. The goal of the landed cost exercise is to be able to compare the landed cost of product to the price of similar locally produced products or the landed cost of other foreign suppliers to the market. (The following calculations use U.S. dollars to make comparisons easier. Clearly the prices should be converted into local currency.)

Line cost items: U.S. product

1. CIF calculation: Ex Works’ price (Los Angeles) $10,000
2. Freight (LA–Sao Paulo): $1,200
3. Insurance: $200
4. CIF price (cost, insurance, freight): $11,400

Landing charges:

5. Import Duty (20% of CIF): 2,280
6. Post Costs/AFRMM (merchant marine tax–25% of ocean freight): 300
7. Warehousing and expediter (0.65% of CIF): 74
8. Terminal handling charges (average $315 per container): $315
9. Compulsory contribution to the Custom Broker's Union (2% CIF or minimum of U.S. $140 and maximum of U.S. $280): $228
10. Custom brokerage fee (average) $700
11. Bank costs (1 to 3% of Ex Works price): $200
12. Total landing charges: $4,097
13. Landed Sao Paulo cost (internal taxes not included): $15,497

This calculation begins by determining the CIF price. The CIF price is calculation of the invoice price (or cost) plus insurance plus freight. It is calculated separately because the CIF will be used later for Brazilian tax calculations. The CIF calculation is shown in line 4.

Next, the landing charges are added. These are all the costs associated with having the product ready for the distributor: the Brazilian import duty, local port-warehouse-terminal costs, custom clearance costs, and bank costs. These costs are itemized in lines 5–11. The total landing charges are $4,097 as shown in line 12. This total is added to the CIF price to calculate the Landed Cost. The landed cost for the U.S. product is $15,497, as shown in line 13.

Step 2: Calculating the distributor and retail price

The landed price is the beginning point for the distributor's calculation of the selling price to the retail store. The distributor pays $10,000 to the U.S. manufacturer, but also pays the landed charges. Thus, the final cost of the product to the distributor is the landed cost, or $15,497. Local taxes and the distributor's markup will be added to this price.

From discussions with industry experts and potential foreign distributors, the U.S. manufacturer has anticipated the markups for its products. In this example, the distributor applies a 33 percent markup and the retailer a 40 percent markup. (These percentages will vary by market, industry, and channel characteristics. The markups used in this example may be low.)

1. Cost to Brazilian distributor: $15,497
2. Markup by distributor (33%): $5,114
3. Selling price to retailer: $20,611
4. Markup by retailer (40%): $8,244
5. List price for Brazilian consumer before local taxes: $28,855

After the 33 percent markup, the distributor will sell to the retail store at $20,611 as shown in line 3. After the retail store's 40 percent markup, the retail price (before local taxes) is $28,855, as shown in line 5.

Local taxes

The local taxes must next be applied to determine the final amount the enduser will pay for the product. These taxes vary by country and local province or state. In the case of Brazil, there are two local taxes to be added: (1) the manufactured products tax (IPI) and (2) the local state tax (ICMS). These are important taxes to calculate because they have a dramatic impact on the final price and will exacerbate the price comparisons done later. Also, the ICMS is a cascading tax—a tax applied on top of a previous tax—which only makes the situation worse.

1. List price for Brazilian consumer before local taxes: $28,855

2. Local taxes:

(1) IPI (manufactured products tax) 12% on CIF plus import duty, plus 12% on all profit addons in the distribution channel:

CIF: $11,400

Duty: $2,280

Distributor markup: $5,114

Retailer markup: $8,244

Cost for IPI calculation: $27,038

3. IPI: 12% $3,245

(2) ICMS (local state tax)

18% on CIF + duty + IPI, plus 18% on all profit add-ons in the distribution channel: CIF: $11,400

Duty: 2,280IPI: $3,245

Distributor markup: $5,114

Retailer markup: $8,244

Cost for ICMS calculation: $30,283

4. ICMS: 18% $5,457

5. List price to final consumer including local taxes: $37,551

The IPI is calculated first because it will be used in the ICMS calculation. As shown in line 3, the IPI is $3,245. It is 12 percent of the CIF plus import duty plus distributor and retail markups. The ICMS is calculated next. As shown in line 4, it is $5,451. It is 18 percent of everything used for the IPI plus the IPI itself. These two taxes are then added to the before tax retail price of $28,855 to calculate the list price including local taxes of $37,551, as shown in line 5. The $37,551

Tap the figure to expand to full-screen.

Cost Items:	U.S. Product	Local Brazilian Product	Example if no duty paid on foreign import such as Argentina
1 CIF calculation: Ex Works price (Los Angeles)	$10,000	$10,000	$10,000
2 Freight (LA –Sao Paulo)	1,200	None	1,200
3 Insurance	200	None	200
4CIF price (cost, insurance, freight)	11,400	$10,000	11,400
5. Landing Charges: import duty (20% of CIF)	2,280	None	-duty free-
6. Post costs/AFRMM (merchant marine tax – 25% of ocean freight)	300	None	300
7. Warehousing and expediter (0.65% of CIF)	74	None	74
8. Terminal handling charges (average $315 per container)	315	None	315
9. Compulsory contribution to the Custom Broker's Union (2% CIF or minimum of US$140 and maximum of US$280)	228	None	228
10. Custom brokerage fee (average)	700	None	700
11. Bank costs (1% to 3% of exworks price)	200	None	200
12. Total landing charges:	$4,097	None	1817
13. Landed Sao Paulo cost (internal taxes not included)	$15,497	$10,000	$13,217

needs to be compared with other products (both local and Argentine) to determine if the U.S. product is competitive.

Step 3: Price comparisons

To compare the U.S. product with a Brazilian and Argentine product, the first two steps are repeated for the other products.

Notice the tremendous competitive advantage of the Brazilian product. Because it is already available to the distributor in Sao Paulo, it has no freight, insurance, or landing charges, including no import tax. This demonstrates the impact of freight and taxes on an international export. Assuming a Brazilian manufacturer could produce the same product at $10,000, it would have a $5,497 cost advantage over the U.S. product, as shown in line 13. As you will soon see, this has a tremendous impact on the final price paid by the consumer.

The Argentine product also has an important cost advantage. Even though it has many of the same landing charges, it does not have an import duty due to the Mercosur free trade agreement. (Note that the freight cost of $1,200 was retained so only the difference of not having

Tap the figure to expand to full-screen.

Cost Items	US Product	Local Brazilian Product	Example if no duty paid on foreign import such as Argentina
1. Cost to Brazilian customer (distributor/agent)	$15,497	$10,000	$13,2172
2. Markup by distributor (33%)	$5,114$3	$3,300	4,362
3. Selling price to retailer	20, 611	13,300	17,579
4. Markup by retailer (40%)	$8,244	$5,320	7,032
5. List price for Brazilian consumer before local taxes	$28,855	$18,620	$24,611

to pay an import duty will affect the final price. Obviously, the Argentine product will have an even greater cost advantage assuming freight costs from Argentina to Brazil are less than from the U.S.).

Distributor and retail prices for the Brazilian and Argentine products

Repeat Step 2 to get the distributor and retail prices.

The same margins are applied to the Brazilian and Argentine products that were applied to the U.S. product. Even before local taxes are added, some significant price differences are apparent, especially for the Brazilian products.

Tap the figure to expand to full-screen.

Cost Items	US Product	Local Brazilian Product	Example if no duty paid on foreign import such as Argentina
1. List price for Brazilian consumer before local taxes	$28,855	$18,620	$24,611
2. Local taxes: 1) IPI (12%)	$3,245	$2,234	$2,953
3. 2) ICMS (18% local state tax)**	$5,451	$3,753	$4,962
4. List price to final consumer including local taxes	$37,551	$24,607	$32,526

Local taxes

Finally, local taxes are added to complete the pricing comparison.

*Basis for calculation: The IPI (manufactured products tax) is calculated as 12% on CIF or distributor/agent price, plus import duty if applicable, plus 12% on all profit add-ons in the distribution channel. In the case of the U.S. Product, the 12% was applied to (11,400+2280+5,114+8,244) =$27,038 cost base. In the case of the

Local Product, the 12% was applied to:
(10,000+3,300+5,320)=$18,620 cost base. And in the case of the Argentine Product, the 12% was applied to:
(13,217+4,362+7032)=$24,611 cost base.

**Basis for calculation: The ICMS (local state tax) is 18% on CIF or distributor/agent price, plus import duty if applicable, plus all profit add-ons in the distribution channel, plus IPI. In the case of the U.S. Product, the 18% was applied to:
(11,400+2,280+5,114+8244+5,114)=$30,283 cost base. In the case of Local Product, the 18% was applied to:
(10,000+3,300+5,320+2,234)=$20,854 cost base. And in the case of the Argentine Product, the 18% was applied to
(13,217+4,362+7,032+2,953)=$27,564 cost base.

Analysis of the price difference with the Brazilian competitor

We return to the initial question: Is the $10,000 price offered by the U.S. manufacturer competitive with a Brazilian product? As shown, the list price before taxes for the Brazilian product is $18,620, and $24,607 after taxes. The list price of the U.S. product is $37,551 with taxes—a difference of $12,944! How can the pricing be so different when the U.S. and Brazilian manufacturers are both selling the product for $10,000?

The extraordinary difference is the result of two factors. First, the international freight costs and import duty alone create a $5,497 cost disadvantage for the U.S. product. Second, this cost disadvantage gets worse when the distributor and retail markup are added. Although both markups are equal for the Brazilian product, 33 percent and 40 percent respectively, the higher starting price of the U.S. product widens the gap between the two products. Essentially the distributor and the retailer make a profit not only on the $10,000 cost of the U.S. product, but also on the $5,497 add-on. To make matters worse, the same thing happens with the taxes. Because the ICMS state tax is a cascading tax, the U.S. product's list price keeps going higher.

While the distributor, dealer, and Brazilian federal and state governments will make more money from these costs, will the U.S. product even sell at this significantly higher price? With such a price difference, the U.S. product will need to be significantly better in quality, features, or some other value that warrants such an increased cost to the consumer. Another concern is if the Brazilian manufacturer bypasses the distributor and sells directly to the retail network. This would eliminate a significant markup in the distribution channel, even if the manufacturer adds some markup. The U.S. exporter doesn't have this option because it requires the use of a distributor to represent it locally.

International price escalation

This pricing exercise is a good example of international price escalation—the tendency for products to sell for a higher price in foreign markets than in their domestic markets. What many exporters do not realize is that freight costs are just the beginning. Once duties, local taxes, and markups in the distribution channel are factored into the pricing calculation, the list price increases considerably. When you see these factors in an actual example you can see why global reductions in tariffs is a U.S. trade policy priority.

Analysis of the price difference with the Argentinian competitor

The Brazilian product's pricing demonstrated the significant cost disadvantage of a U.S. manufacturer versus a Brazilian manufacturer. But what if there were no local competitors? What if the competition came from Argentina, Japan, or Germany?

This is where the calculations become a bit more complex because the application of each cost factor may not apply equally to all foreign imports. Assuming each foreign country's products will be applied the same import duty as U.S. products, the calculation should be the same—no advantage or disadvantage for the foreign products.

However, as our example illustrates in the final column, if the exporting country has signed a treaty to reduce duties, such as Argentina, the impact can be significant. You may be surprised at the difference the lack of the duty makes on the final prices. As the Argentine pricing shows, though all other costs such as freight and bank charges are the same, the resulting price to the consumer is $5,610 less ($37,551 versus $31,941). As with the U.S.-Brazilian comparison, the difference grows significantly due to the nature of markups and cascading taxes. This helps demonstrate the difference of U.S. products compared to imports from countries that have signed a free trade agreement with another country.

Dealing with international pricing concerns

As shown in the previous example, exporting can be a difficult proposition if your products are more expensive than local products or do not offer some significant benefits. Furthermore, other foreign imports may have an important advantage if their duty rate is lower than the U.S. rate. So what are some options to deal with international price escalation and competition with local products?

Long-term price problems

There may not be an answer in the short term. The freight, duty, taxes, and related costs may simply make a U.S. product completely noncompetitive in a particular market. You need to analyze specifically what is contributing to the problem, for example, freight, duties, or both, and then plan other options. Your analysis may result in the decision that pure exporting is not a viable option, in which case you can investigate these other options.

Partial manufacturing

Rather than export the final product, freight and duty costs may become more favorable if you export the product partially finished. Sometimes this results in a lower tariff because the commodity may be classified under a different harmonized code. It also could result in significant freight cost savings if the product can be shipped in greater bulk.

Local assembly

Similar to partial manufacturing, you can ship components or assemblies, which are then assembled into a final product in the foreign market. This would probably reduce the duty, especially if some local components are included in the assembly process.

Foreign manufacturing

If import duties have you beat, you can manufacture the product in the foreign market. The location may be in the specific foreign market under study or a nearby market, particularly if the nearby market has signed a free trade agreement with the target market.

Licensing

If manufacturing in the foreign market can be done by an outside company and your proprietary technology is required to manufacture the product, licensing may be an option.

Short-term price problems

If your price challenges don't necessitate the expensive and risky options listed above such as foreign manufacturing, you may be able to effectively deal with price escalation by using these short-term solutions:

Product differentiation

A textbook example of dealing with a pricing challenge is to shift the focus from pricing to benefits and features—product differentiation. This may be easier in a foreign market that your U.S. competition has not entered. For example, in many foreign markets U.S. fast food chains have had the entire market to themselves with no competition from their U.S. rivals. This makes product differentiation particularly easy because no other authentic U.S. fast food is offered in the market.

Challenge the distribution rules

Part of the challenge in many foreign markets is the long distribution channel which contributes to the price escalation. You may be able to identify ways to bypass the distribution channel. For example, if using the established channel would be too expensive, consider selling directly to retailers or key accounts. This would eliminate one or two levels in the chain. If some local presence is needed, an agent may be the most appropriate representation. There also may be local distributors who are in the process of changing the distribution rules. For example, when I was searching for a computer distributor in the U.K. in the mid1980s, some distributors were beginning to sell directly to key accounts. It was considered a rogue act in the market at the time, but if I believed a flatter distribution channel was needed for our products, I could have chosen such a distributor which would have decreased my costs.

Choose your representation based on pricing structure

If you decide to stay with the established distribution structure, consider appointing a distributor that has agreed to offer aggressive pricing. For example, perhaps you could find a distributor who will work with a 20 percent markup rather than a 33 percent markup.

Lower your pricing

An obvious option is to simply lower your pricing. For example, you could argue that for a time, international pricing should be calculated using variable costing, discussed later in this chapter, which would result in a lower target selling price. However, be sure to do your calculations carefully. As shown in the Brazilian example, it would take a considerable cost decrease to compete with local products.

Pricing structure, discounts, and promotions

Look into offering discounts tied to promotions, or quantity discounts, which are more aggressive than those in your domestic price structure are. For example, some include cooperative advertising money for foreign buyers. For each invoice, a certain percentage (usually 2–4 percent) is accrued in an account. The distributor or agent could then use that money for any marketing activities such as advertising or trade shows.

Developing a pricing structure

Once you have all the pricing research completed, including landed cost and projected end-user pricing (using standard markups), as well as local market issues such as consumer ability to pay and competitive pressures, you are in a position to develop your pricing structure. First you must determine your profit requirements for your international sales which involves choosing full or variable costing.

Variable costing vs. full absorption costing

Variable costing is a product costing method where the only costs allocated to products are those which are directly related to the production or sales of the product. On the other hand, full absorption costing allocates all manufacturing costs (variable and fixed) as well as non-manufacturing costs such as factory overhead, sales and marketing overhead, and even corporate overhead (executive salaries, headquarters costs, and R&D). Variable costing results in a lower cost than full costing, so the selling price of a product using the variable costing method will be less than a product using full costing methods assuming the same profit margin is applied.

The idea behind variable costing is profit maximization in which a firm should increase its output until marginal revenue equals marginal or variable cost. In other words, a company can justify lowering prices to achieve increased sales as long as all direct costs will be covered. In the long run, in order to fund corporate overhead and other non-direct costs, full pricing must be used at some point or the company will lose money and not be able to fund future activities.

In practice, most companies employ variable costing in strategic pricing decisions, such as new product pricing, discontinuing a product, bid pricing, and with private label and joint products. These special pricing instances can justify a variable costing approach if the company believes sales would not be achieved without the lower pricing or that lower pricing is justified for competitive reasons. For routine price decisions, a company would use full absorption costing.

International pricing

Full or variable costing? The question then becomes, should international sales be considered a strategic pricing decision and justify the use of variable pricing? The impact will be significant. If items such as manufacturing overhead, R&D, and other overhead items are not included in the costing calculation, the international pricing will be much lower, and thus more competitive in the international marketplace.

The answer depends on the short and long-term corporate view of the international expansion effort. A fully involved global player, such as a Fortune 500 company, will probably employ full costing methodology in its international pricing strategy. The view is that its international sales are no less or more important than its domestic sales. They are simply part of the overall mix. Thus, full costing is used to ensure long-term corporate viability.

Small to mid-sized companies, especially in early stages of international expansion, might easily justify variable costing. For example, it is unlikely that an increase of 10–20 percent in sales from the international expansion would have much of an impact on management salaries, the manufacturing facility overhead, or corporate overhead. There will be direct sales and marketing expenses, such as travel, commissions, and advertising, but other overhead items will probably remain constant. You could argue that in the short term it would be important to use a variable costing strategy for international pricing calculations.

Whether full or variable costing is used, the individual developing the international pricing strategy should be aware of the issue so it can be fully discussed during the international planning process. A company should avoid the mistake of taking international sales for granted and placing a higher profit expectation on them than domestic sales. More than once, companies have taken the view that its international sales are a burden and require more profit. As a strong proponent of international sales, I find such a perspective quite narrow! I would hope a company at least prices its exports at the same level as domestic sales.

Market conditions & competitive position

The discussion of variable versus full absorption costing was intended to raise the issue of accounting costing methods used for developing your international pricing strategy. It was not meant to overshadow the fundamental issue of developing your international pricing and that is to consider the foreign market structure and competitive position of your products. By foreign market conditions, I am referring to issues such as the consumers' ability to buy, distribution options, consumer expectations, regulatory and political environments, and industry structure. By competitive position, I am speaking of the issue of how your product will compete in a particular foreign market: on the basis of product differentiation, lower cost, improved customer service, or quality. Both issues will mirror your domestic pricing philosophy because your domestic market strategy will probably be similar to your method of competing internationally. But because foreign markets can be quite different than the U.S. market, your competitive position may need to be different.

Ultimately, your international pricing strategy must be driven by the fundamentals of the foreign markets and your ability to compete. What makes the challenge greater than that of establishing a domestic pricing policy is the sheer number of variables, both known and unknown. For example, you may know the landed price based on current tariff rates, but you will not know the exchange rate position for the future. That one unknown is significant because local competitors will not face the challenge of exchange rates. International pricing will probably always be a best guess process of trial and error, especially in the early stages of international expansion. Once you have experience with a few international markets, you will be in a much better position to more effectively establish your international pricing.

Consistent pricing between international markets

You want consistent pricing between foreign markets (assuming similar competitive strategies), especially within a given region where trade occurs within adjacent markets. If your pricing varies too greatly within the region, gray marketing will occur, in which a foreign buyer with a lower price will sell around another foreign buyer with a higher price. This can happen even with consistent pricing and the legal framework of the country may prevent you from stopping it. Consistent pricing is the easiest and fairest strategy to implement.

There are, however, occasions where market conditions necessitate different pricing strategies. For example, competitive factors or government restrictions may necessitate that you offer prices lower than your standard international pricing. How much you lower depends on your goals and expectations for the particular market. It also depends on the time frame of how quickly you want to gain brand recognition and market share. But be careful—it is always more difficult to raise prices than to lower them later.

Who pays what?

Another important issue of developing your international pricing structure is to identify which costs you will pay as the manufacturer and which costs the foreign buyer will pay. Most often this involves establishing your freight terms. For example, you may establish your pricing as ExWorks Dallas, which means you will provide the goods for pickup from your facility in Dallas and your buyer will pay all costs onward. On the other hand, you may specify CIF–Hong Kong, which means freight and insurance will be paid by you, but the foreign buyer must pay all customs charges and duties.

This issue of who pays what is always difficult. Some argue it is best to always price your goods ExWorks from your location. This is the least work and risk for you and puts the burden on the buyer. The reasoning for this is that foreign buyers are accustomed to importing so it is better if they arrange the logistics. This generally leads to lower costs overall.

The argument also can go the other way. You can arrange a worldwide logistics contract with a U.S. shipping company, reducing the overall freight impact, and offer CIF for the foreign country. This can lower the landed cost in each country. It also creates less work for your buyer, which may make your products more desirable.

There is no correct answer, but you should consider a couple of factors when deciding on your freight terms. Determine what is commonly accepted in your industry for a particular market. If the accepted practice is Ex Works, you are probably okay if you keep with that standard. If your strongest competitor is offering CIF–Hong Kong, you may be forced to match the terms. You should also determine what capability your company has to handle freight and logistics issues. The less experience and desire to be involved in freight, the greater the argument to price your goods Ex Works.

Which currency?

A final consideration you need to make early in your global expansion is in what currency to price your products and services. It is easiest to simply price everything in U.S. dollars. However, competitive or foreign buyer pressure may force you to offer pricing in the local currency of the foreign market.

The essence of this decision is the risk. U.S. dollar based pricing places all foreign currency risk on your foreign buyers. Foreign currency based pricing places the risk on the U.S. supplier. Once pricing has been established, and the exchange rate between the two currencies changes, one of the two parties must absorb the difference or pass it on to the consumer. In the case of U.S. dollar based pricing, the foreign buyer absorbs the difference—either the distributor or the consumer or a combination. In the case of foreign currency based pricing, the exporter absorbs the change, assuming the exporter does not alter prices.

The issue is most serious when the dollar becomes stronger visàvis the foreign currency because a stronger dollar means more of the foreign currency is used to purchase one U.S. dollar. This effectively increases the cost of the U.S. product.

It is fair to say most small to midsized companies, especially in early stages of international expansion, price in U.S. dollars. They simply do not have the experience to take on the risk of foreign currency pricing. This is not to say that specific transactions, such as bids or particular projects, aren't priced in the foreign currency. The exchange rate risk of such special situations are easily covered by traditional foreign exchange products available from banks.

You should never underestimate the competitive advantage of pursuing foreign currency pricing. Once a company understands that someone has to absorb foreign exchange movements, it becomes easier to justify a more aggressive pricing policy that includes foreign currency pricing. The risk is simply figured into the margin. The competitive advantage of offering stable, foreign currency pricing may outweigh the costs. Seek assistance from a bank with international experience to investigate these options.

The previous section is taken from *The Global Entrepreneur: Taking Your Business International*, by James Foley.

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